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IN AN ordinary[1] bankruptcy proceeding, at the first meeting of creditors, a trustee in bankruptcy is elected or appointed. His duty is to collect, preserve and liquidate the assets of the estate and distribute them to creditors.[2] The court may, under special circumstances, authorize the trustee to conduct and operate a bankrupt's business.[3] Normally the court will do so only when the trustee believes that a higher price could be received for the assets by selling the business as a going concern, or when work in progress can be completed at a substantial profit to the estate—particularly where completion of the work will avoid substantial claims for damages for breach of contract.

A receiver, although not appointed in every bankruptcy case, may be appointed to preserve and protect the assets of the debtor in involuntary bankruptcy proceedings pending a determination whether there will be an adjudication in bankruptcy or a dismissal. A receiver may likewise be appointed to protect and preserve the assets from the date of adjudication to the election of a trustee in bankruptcy.[4]

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[1] As distinguished from a debtor proceeding under chapters IX-XIII of the Bankruptcy Act.

[2] Bankruptcy Act § 47(a)(1), 52 Stat. 860 (1938), 11 U.S.C. § 75(a)(1) (1958); 1 COLLIER, BANKRUPTCY 229 (14th ed. 1962).

[3] Under Bankruptcy Act § 2(a)(5), 52 Stat. 842 (1938), 11 U.S.C. § 11(a)(5) (1958), courts of bankruptcy have the power to "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. . . ." *In re* Wiener, 7 F. Supp. 691 (1932), states that this "extraordinary" power is limited to "exceptional cases." See also 2 CLARK, RECEIVERS 674 (3d ed. 1959).

[4] Under Bankruptcy Act § 2(a)(3), 52 Stat. 842 (1938), 11 U.S.C. § 11(a)(3) (1958), bankruptcy courts have the power to "appoint, upon the application of parties in interest, receivers or the marshals to take charge of the property of bankrupts and to protect the interests of creditors after the filing of the petition and until it is dismissed

Normally a receiver appointed after adjudication will be authorized to conduct and operate the business only when a trustee would be authorized to do so. However, a receiver appointed prior to adjudication will in many cases be authorized to conduct and operate the enterprise to protect the alleged bankrupt from loss of his business in the event there is no adjudication in bankruptcy and the petition is dismissed.

Proceedings under Chapter XI of the Bankruptcy Act normally contemplate that the debtor will seek either to obtain an extension of time to pay his creditors or to make a composition with his creditors. It is the practice in some districts to leave the debtor in possession pending approval of his plan of arrangement, whereas in other districts a receiver is always appointed. Because Chapter XI proceedings seek rehabilitation rather than liquidation of the debtor, the receiver under Chapter XI will normally be directed to conduct and operate the business.[5]

When a Chapter XI proceeding is filed in a pending bankruptcy proceeding after the election of a trustee, the trustee continues in office,[6] but acts in the same manner as if he were a receiver appointed in the Chapter XI proceedings.[7]

In proceedings under Chapter X of the Bankruptcy Act (corporate reorganizations) and in the relatively rare proceedings under Chapter XII (real estate reorganizations by individuals), the trustee, if appointed, normally conducts the debtor's business. In corporate reorganizations under Chapter X of the Bankruptcy Act, the object is to "preserve, if possible, the going-concern values of the debtor in contrast to the forced sales and depressed values of outright liquida-

or the trustee is qualified." See also General Order 40, Bankruptcy Act (as amended, Jan. 16, 1939): "A receiver or marshal appointed by the court to take charge of the property of a bankrupt after the filing of a petition, shall be deemed to be a mere custodian within the meaning of section 48 of the Act, unless his duties and compensation are specifically enlarged by order of the court, upon proper cause shown, either at the time of the appointment or later."

[5] Bankruptcy Act § 343, 52 Stat. 909 (1938), 11 U.S.C. § 743 (1958): "The receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate." As in ordinary bankruptcy, however, the receiver in chapter XI is not empowered to continue the business without express authority to do so. 8 COLLIER, BANKRUPTCY 984-85 (14th ed. 1962).

[6] Bankruptcy Act § 332, 52 Stat. 908 (1938), 11 U.S.C. § 732 (1958): "The court may, upon the application of any party in interest, appoint, if necessary, a receiver of the property of the debtor, or, if a trustee in bankruptcy has previously been appointed, shall continue such trustee in possession."

[7] Bankruptcy Act § 343, quoted at note 5 *supra*.

tion."[8] Accordingly, section 189 of the Bankruptcy Act provides that "A trustee or debtor in possession, upon authorization by the judge, shall operate the business and manage the property of the debtor during such period, limited or indefinite, as the judge may from time to time fix." Without such authorization, however, a Chapter X trustee has only the normal powers of a bankruptcy trustee.[9]

Liability of a Receiver or Trustee in General

A receiver in bankruptcy, trustee in bankruptcy, or a trustee in reorganization has no inherent authority to conduct and operate the business of the bankrupt or debtor. He must be authorized to do so by the court appointing him.

Under the common law, a receiver has the duty of exercising reasonable care in the conduct of the fiduciary estate unless relieved of that duty by an order of the court or a particular statute. The same rules apply in bankruptcy proceedings.[10] Therefore, a receiver or trustee authorized to operate a business should secure from the court orders specifically directing him to do any acts in which a question might later arise as to whether reasonable judgment had been exercised.

While a trustee or receiver is personally liable for any negligence or wrongful handling of the estate he is not an insurer of the successful management of the debtor's business and personal liability will not ordinarily be imposed on him for mere mistakes in judgment where reasonable care or diligence has been exercised.[11] Where the fiduciary negligently handles the bankrupt estate, however, his account may be surcharged for any loss resulting to the estate.[12]

Once he has embarked on the course of continuing a business the trustee or receiver may have to decide whether circumstances require that it be discontinued and liquidated. This is of particular importance when he discovers that the business cannot be operated at a profit. Usually a business that has come under the jurisdiction of the bank-

[8] 6 COLLIER, BANKRUPTCY 2445 (14th ed. 1962).

[9] Bankruptcy Act § 187, 52 Stat. 892 (1938), 11 U.S.C. § 587 (1958).

[10] United States *ex rel.* Willoughby v. Howard, 302 U.S. 445 (1938), in which a trustee in bankruptcy was held personally liable for depositing funds of the estate in an approved banking depositary which he knew to be unsafe.

[11] 6 COLLIER, BANKRUPTCY 2458-59 (14th ed. 1962). See also 2 CLARK, RECEIVERS 656 (3d ed. 1938).

[12] United States *ex rel.* Willoughby v. Howard, 302 U.S. 445 (1938); Carson, Pirie, Scott & Co. v. Turner, 61 F.2d 693 (6th Cir. 1932). It has been held that the fiduciary's duty of care to the estate may include insuring it against loss, thus subjecting him to personal liability to the estate for failure to do so. Hartford Acc. & Indem. Co. v. Crow, 83 F.2d 386 (6th Cir. 1936). See also *In re* P-R Holding Corp, 84 F. Supp. 467 (S.D.N.Y. 1949), where a trustee was surcharged for authorizing non-customary painting of a hotel.

ruptcy court has a record of losses, and its continuance can frequently be expected to result in further losses to the estate. Losses may be justified where the conduct of the business will result in a higher price for the assets or a reduction in claims for breach of contract. If the business is being conducted for other reasons,[13] the fiduciary risks personal liability if, as soon as he reasonably determines that losses are being sustained, he fails to inform the court and give it the opportunity to determine the plausibility of continuing the business.

In an equity receivership, a district court held the receiver to be under a duty to inform the court immediately and subjected him to a surcharge for losses sustained after the date when he should have sought the court's advice.[14] The Court of Appeals for the Seventh Circuit, however, has held a trustee in bankruptcy not chargeable for losses where he operated the business for six months while looking for a purchaser,[15] stating "the general rule is that receivers are not chargeable with losses resulting from operation of a business, although it is their duty to exercise diligence in selecting competent employees and informing themselves as to profits and losses from such operation."[16] The court further stated that the degree of diligence is a question of fact for the court to determine, and therefore one court may refuse to surcharge a trustee for what another court has in the past found to be a negligent act.

The Bankruptcy Act specifically requires a trustee in reorganization in a Chapter X proceeding to file reports on the business with the court "at such intervals as the court may designate."[17] There is no such requirement in ordinary bankruptcy proceedings, but a prudent trustee or receiver will keep the court advised of any changes in the business, and he will also keep the creditors' committee advised, if one has been formed.[18]

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[13] *E.g.*, to realize prospective profits from a current contract.

[14] *In re* Consumer's Coffee Co., 162 Fed. 786 (E.D. Pa. 1908), where the receiver was held liable for losses sustained after he should have known that the restaurant business could not be operated at a profit; he did not report the losses to the court, nor did he keep adequate records. See also United States *ex rel.* Merchants & Mfrs. Sec. Co. v. Johnson, 98 F.2d 462 (8th Cir. 1938); Wire Wheel Corp. v. Fayette Bank & Trust Co., 30 F.2d 318 (7th Cir. 1928) (dictum).

[15] *In re* Breger Kosher Sausage Co., 129 F.2d 62 (7th Cir. 1942).

[16] *Id.* at 64.

[17] Bankruptcy Act § 189, 52 Stat. 892 (1938), 11 U.S.C. § 589 (1958).

[18] A debtor in possession has the responsibility of a receiver or trustee. 6 COLLIER, BANKRUPTCY 2438 (14th ed. 1962); *In re* Avorn Dress Co., 78 F.2d 681 (2d Cir. 1935). It would therefore be interesting to speculate whether a debtor in possession would incur post-bankruptcy liability for continuing a business after he had knowledge that it could not be operated profitably.

At the outset a trustee or receiver appointed after adjudication is under no duty to run the business rather than liquidate it unless he is directed by the court to do so. It has even been held that he is under no duty to request such authority where it would appear beneficial to the estate.[19] A receiver might incur liability pending adjudication if he terminates a profitable business and a dismissal of the proceedings rather than an adjudication in bankruptcy results.

Liability on Contract

A receiver or trustee running a business must often enter into contracts. The most common are contracts for the purchase of goods on credit, the borrowing of money, and agreements involving sales.

A trustee or receiver upon authorization of the court may borrow money to run the business and issue certificates of indebtedness or pledge assets of the estate as security.[20] The power to continue the business does not in itself imply the power to place liens upon the assets of the estate as security for the loans.[21] It has been held that where a court authorized a trustee to borrow a specified amount of money he could not claim implied power to borrow more.[22] In an equity receivership, it was held that where there was specific and limited authority to borrow money, the purchasing of goods on credit is equivalent to borrowing and is impliedly forbidden if the limit for borrowing is passed.[23]

While it has been stated that the power to borrow money is not implied in an order authorizing the continuance of the business in ordinary bankruptcy cases[24] and even in corporate reorganizations,[25] the Court of Appeals for the Seventh Circuit has held that a debtor in possession, having the same powers and rights as a trustee, had the implied power to purchase a limited amount of goods on credit and even to borrow money to pay for the goods.[26]

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[19] *In re* Wiener, 7 F. Supp. 691 (E.D. Pa. 1932).

[20] See 1 COLLIER, BANKRUPTCY 233 (14th ed. 1962) (ordinary bankruptcy); 6 COLLIER, *op. cit. supra* at 717-21 (corporate reorganizations); Bankruptcy Act § 116(2), 52 Stat. 885 (1938), 11 U.S.C. § 516(2) (1958).

[21] *In re* Avorn Dress Co., 78 F.2d 681 (2d Cir. 1935); see also *In re* Lerner, 41 F. Supp. 940 (E.D.N.Y. 1941).

[22] *In re* C. M. Burkhalter & Co., 182 Fed. 353 (S.D. Ala. 1910).

[23] Haines v. Buckeye Wheel Co., 224 Fed. 289 (6th Cir. 1915).

[24] 1 COLLIER, BANKRUPTCY 231 (14th ed. 1962). Childs v. Empire Trust Co., 54 F.2d 981 (2d Cir. 1932).

[25] 11 REMINGTON, BANKRUPTCY 212 (5th ed. 1961). See also *In re* Avorn Dress Co., 78 F.2d 681 (2d Cir. 1935); Standard Capital Corp. v. Saper, 115 F.2d 383 (2d Cir. 1940); in both cases there had been limited, explicit authority to borrow.

[26] *In re* J. C. Groendyke Co., 131 F.2d 573 (7th Cir. 1942).

In at least one case where the trustee lacked express authority to borrow money, the court stated that the repayment of a loan would be allowed as a matter of equity and as an expense of administration. It appeared that the loan would have been authorized upon timely application and the creditors had not been injured by the continuance of the business which the loan made possible. The trustee believed that he had authority and the court found that this was an element of good faith.[27]

The implication of authority to borrow limited funds or to purchase goods on credit, where reasonably required under the circumstances, is consistent with the duty of the fiduciary to carry on the business in the ordinary way.[28] However, to be safe, the receiver or trustee should apply for express authority from the court to borrow money.

One loaning money to a bankrupt estate should see that the order of the court authorizes the loan. One dealing with a bankrupt estate deals "at his peril" as to the authority of the trustee or receiver. Such statements have been relied upon in denying the creditor the right to recover from the estate.[29] Although there are cases permitting recovery against a receiver individually where he borrowed money or purchased goods on credit without authority of the court,[30] it would seem that the

[27] *In re* American Cooler Co., 125 F.2d 496 (2d Cir. 1942); see also Northern Fin. Co. v. Byrnes, 5 F.2d 11 (8th Cir. 1925).

[28] *In re* J. C. Groendyke Co., 131 F.2d 573 (7th Cir. 1942); see also Holeman v. Natural Soda Prods. Co., 96 F.2d 277 (9th Cir. 1938).

[29] "All persons dealing with receivers do so at their peril, and are bound to take notice of their incapacity to conclude a binding contract without the sanction of the court." [Quoting Lehigh Coal & Nav. Co. v. Central R.R., 35 N.J. Eq. 426 (1882)] "Although, as receiver, he may enter into negotiations and make such agreements as would be binding upon him as an individual, yet, in order to affect the fund in his hands his acts must be ratified by the court. This rule is so well established that it has been decided that all persons contracting with a receiver are chargeable with knowledge of his inability to contract, and enter into contracts with him at their own peril, and that the court has unquestioned power to modify or even vacate his agreements." [Quoting BEACH, RECEIVERS § 257 (1905)]

Chicago Deposit Vault Co. v. McNulta, 153 U.S. 554, 562-63 (1894).

> The lender acts at his peril in accepting such [receiver's] certificates; he must examine the debtor's—or receiver's—authority and satisfy himself of its sufficiency.

Standard Capital Corp. v. Saper, 115 F.2d 383, 384 (2d Cir. 1940).

> [A] debtor continued in possession by court order is in a position analogous to that of a receiver in equity. The appellant concedes that the cases hold that parties dealing with a receiver act at their peril and courts, as a rule, refuse to recognize contracts made by a receiver outside the authority conferred upon him.

In re Avorn Dress Co., 79 F.2d 337 (2d Cir. 1935).

[30] Haines v. Buckeye Wheel Co., 224 Fed. 289 (6th Cir. 1915); *In re* Erie Lumber Co., 150 Fed. 817 (S.D. Ga. 1906); Noyes v. Gold, 310 Ill. App. 1, 34 N.E.2d 1 (1941).

rule that one deals at his peril with a bankrupt estate should preclude recovery from the receiver personally, at least where the trustee or receiver does not intentionally misrepresent his authority.

The English and American courts have differed quite radically in their theories of receivers' liabilities. Historically, under the English rule, a receiver was personally liable, in theory, for contractual obligations incurred in his administration of the estate. He, in turn, would be indemnified by the estate against all liabilities properly incurred.[31] The American courts departed from this rule of personal liability and termed the receiver "officially liable."[32] The official liability doctrine was stated by Mr. Justice Brown of the Supreme Court of the United States:

> 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.[33]

Since the official liability doctrine historically would not cover actions of the fiduciary beyond his authority, a few cases have applied the English doctrine of personal liability when a fiduciary acts beyond his authority.[34] These cases should be re-examined in view of their obvious inconsistency with the rule that one acts at his peril in dealing with the fiduciary. To hold the fiduciary personally liable when he acts on behalf of the estate, even though he has no authority to contract, seems unjust where only the estate benefits from the transaction.

Liability in Tort

Much of American law involving receiverships arose from railroad failures during the latter part of the nineteenth century. The official liability rule, the same rule as applied in contract cases, was applied by the courts to protect receivers from liability for the negligent acts of railroad employees.[35] Under the American rule, the estate rather

[31] Clark, *English and American Theories of Receivers' Liabilities*, 27 COLUM. L. REV. 679 (1927).

[32] Clark, *supra* note 31, at 684.

[33] McNulta v. Lochridge, 141 U.S. 327 (1891); see also 2 CLARK, RECEIVERS 663 (3d ed. 1959).

[34] See cases cited *supra* note 30; see also dicta in *In re* Kalb & Berger Mfg. Co., 165 Fed. 895 (2d Cir. 1908); *In re* Polok, 55 F.2d 417 (S.D.N.Y. 1931).

[35] His [the receiver's] relation to the road and its operation was entirely official, and he had no interest in or control over the earnings, and was removable at the pleasure of the court. He was powerless to protect himself against the hazard of the acts of those he was compelled to employ. His position was analogous to that of a public officer charged with public duties, in the performance of which he is compelled to act in part by others. It is a great hardship, in such cases, to impose upon them the hazards and responsibilities which attach to

than the receiver became liable for damages resulting from the torts of employees in the operation of the business.[36] This rule is applicable as well to receivers and trustees in bankruptcy proceedings.[37] The official liability doctrine protects the trustee or receiver from responsibility for negligent acts of employees. It would seem that the doctrine would also offer protection from personal liability for other types of torts committed by employees.

The applicability of the official liability rule becomes more difficult where the trustee personally commits or directs the commission of the tort. There would appear to be no question but that his official position would not protect him from personal liability for torts of violence. The real difficulty is in determining whether the estate or the fiduciary personally is liable for the type of tort innocently committed in the operation of the business. An example is the innocent conversion by the fiduciary of the property of another for the benefit of the estate.

A similar problem arises in the case of a trespass. It would appear that the receiver of a lumber company should not be individually liable for damages for trespass if he orders the cutting of timber on land which he had every reason to believe belonged to the estate. In the only case that has been found holding the receiver personally liable for damages for trespass, it appeared that the receiver took possession of a hotel which he knew the debtor had transferred, on the ground that the transfer was invalid, without first obtaining a judicial decision of the invalidity of the transfer.[38] In another trespass case, the court found that the trespass accrued to the benefit of the estate and permitted the injured party to recover from the estate, stating that if a judgment were rendered against the trustee he would have the right to be indemnified by the estate.[39]

> individuals acting by agents appointed for their own convenience and profit. It would be different if the defendant had sought to do by others that which he was expected and was competent to do in person. But such was not the case. The employment of agents was a necessity, and expressly directed by the court; and if in the performance of this part of his duty, he was prudent, and selected only competent agents, he had discharged his full duty, and ought not to be held to guarantee the acts of the agents employed.

Cardot v. Barney, 63 N.Y. 281, 286-87 (1875), quoted in 2 CLARK, RECEIVERS 660 (3d ed. 1959).

[36] Clark, *supra* note 31 at 685. McNulta v. Lochridge, 141 U.S. 327 (1891).

[37] 2 COLLIER, BANKRUPTCY 1754 (14th ed. 1962). Ziegler v. Pitney, 139 F.2d 595 (2d Cir. 1943); 4 CLARK, RECEIVERS 1901 (3d ed. 1959): "[T]he liabilities of receivers in bankruptcy are predicated on the general usages and rules of equity on the subject rather than on any peculiarities of the bankruptcy acts. . . ."

[38] Fidelity Sav. & Loan Ass'n v. Citizens Trust & Sav. Bank, 186 Cal. 689, 200 Pac. 631 (1921).

[39] *In re* Hunter, 151 Fed. 904 (E.D. Pa. 1907), where, in fact, the trespass was a knowing one.

There are cases holding a fiduciary personally liable for conversion,[40] but there are so many situations where a receiver or trustee could innocently convert property not for his own use but for the use of the estate that there appears to be little justification for holding the fiduciary liable.

The reasoning behind the official liability doctrine, that a trustee or receiver must be protected from liability for the torts of employees which he cannot control or avoid, is equally applicable to situations where the trustee or receiver innocently and reasonably takes possession of another's property for the estate's benefit.

It is therefore the writer's conclusion that where a non-violent tort is committed by a receiver or trustee in good faith and for the benefit of the estate that the estate rather than the receiver or trustee, personally, should be liable.

Taxes

In conducting a business, trustees or receivers in bankruptcy are subject to all federal, state and local taxes applicable to the business to the same extent as if it were being conducted by an individual or corporation.[41] Thus, where the penalty arises during the conduct of the business by the fiduciary, the estate is responsible for the penalty assessed by the taxing authority.[42] This is in spite of the statutory prohibition against a taxing agency proving a claim in bankruptcy for a tax penalty.[43]

In *Boteler v. Ingels*,[44] the court noted that "Whether the trustee might be personally surcharged because his refusal to pay the fees subjected the estate to the increased liability of the penalties, is not presented."[45] This statement implies that a trustee would be surcharged for penalties incurred by failing promptly to pay taxes for which the estate was liable in operating the business.

Conclusion

It is obvious that all trustees or receivers conducting and operating a business assume the duty to do a conscientious job. There are certain

[40] *In re* French, 18 F.2d 792 (W.D. Mich. 1927); see also *In re* Kalb & Berger Mfg. Co., 165 Fed. 895 (2d Cir. 1908) (dictum); *In re* Spitzer, 130 Fed. 879 (2d Cir. 1904) (dictum); *In re* Polok, 55 F.2d 417 (S.D.N.Y. 1931) (dictum); Treat v. Wooden, 138 Fed. 934 (D. Mass. 1905).

[41] 28 U.S.C. § 960 (1958); the fiduciary is responsible in his official capacity under this section. Boteler v. Ingels, 308 U.S. 57 (1939), *affirming* Ingels v. Boteler, 100 F.2d 915 (9th Cir. 1938).

[42] Boteler v. Ingels, *supra* note 41.

[43] Bankruptcy Act § 57(j), 52 Stat. 866 (1938), 11 U.S.C. § 93(j) (1958).

[44] 308 U.S. 57 (1939), *supra* note 41.

[45] *Id.* at 60 n.6.

risks of liability. The courts have recognized in the past that in order to obtain receivers and trustees they must not subject them to liabilities over which they have no control. Where the fiduciary receives no benefit and the benefit is to the estate, regardless of whether the benefit resulted from an unauthorized contract or an unauthorized tort, the courts should hold the estate liable and not the receiver or trustee personally.