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Bankruptcy -- Arrangements -- Priority of Receivers' Loans

Thomas M. Coker Jr.

CASES NOTED

BANKRUPTCY—ARRANGEMENTS—PRIORITY OF RECEIVERS' LOANS

Receivers appointed under a voluntary petition for an arrangement in bankruptcy had their note for $5000 discounted by the bank pursuant to a court order. On the adjudication of the debtor as bankrupt, the bank filed a proof of claim averring priority over costs of administration. *Held,* since authorization did not provide for any priority, the bank must enter on a parity with other administration expense creditors. In re *Delaware Hosiery Mills,* 202 F.2d 951 (3rd Cir. 1953).

The power to appoint a receiver, when a proper showing is made is an inherent power of equity,[1] and apart from statute, the appointment of a receiver is merely a provisional remedy, incidental and ancillary to the primary object of the litigation and cannot of itself constitute the sole or primary purpose of suit.[2] The power of a court of equity to permit a receiver to borrow money is implied from its inherent power to preserve receivership accounts.[3] A receiver is a ministerial officer of the court and can exercise only the power and authority conferred upon him by the court.[4] He must answer to the court.[5] Property in the hands of a receiver is in the custody of the court or as otherwise stated, is in *custodia legis,* and persons dealing with the receiver must take notice of the extent of his authority.[6] The court will make the necessary orders as the exigencies of the situation require.[7] It is the general rule of the federal courts that receivers have very limited powers, and in the absence of special authorization are without power to borrow money, much less to pledge or mortgage the property they hold as security for the repayment of money that they have borrowed without authority.[8] If a receiver borrows money without authorization, he may become personally liable for the loss.[9] The receiver

1. Bayview Homes Co. v. Sanders, 102 Fla. 516, 136 So. 234 (1931); Armour Fertilizer Works v. First Nat. Bank of Brooksville, 87 Fla. 436, 100 So. 362 (1924); Beard v. Viser, 86 Fla. 265, 97 So. 718 (1923).

2. Lewis v. Commonwealth Securities, 51 F. Supp. 33 (D. Del. 1943).

3. Rand v. Merrimack River Savings Bank, 86 N.H. 351, 168 Atl. 897 (1933).

4. Klages v. Freier, 225 Iowa 586, 281 N.W. 145 (1938); Harrison v. Brown, 222 N.C. 610, 24 S.E.2d 470 (1943).

5. Gilles v. Yarbrough, 224 S.W.2d 720 (Texas 1949).

6. Lesser and Son v. Seymour, 35 Cal.2d 494, 218 P.2d 536 (1950); Knickerbocker Trust Co. v. Green Bay Phosphate Co., 62 Fla. 519, 56 So. 699 (1911); Baker v. Metropolitan Life Ins. Co., 221 Ind. 411, 48 N.E.2d 173 (1943).

7. Marmor Ins. Agency v. Ardery, 240 S.W.2d 832 (Ky. 1951).

8. Real Estate-Land Title and Trust Co. v. Commonwealth Bond Corp., 63 F.2d 237 (2nd Cir. 1933); Darling v. Cornstalk Products Co., 54 F.2d 670 (E.D. Ill. 1931); Byrnes v. Missouri Nat. Bank, 7 F.2d 978 (8th Cir. 1925).

9. Naslund v. Moon Motor Car Co., 345 Mo. 465, 134 S.W.2d 102 (1939); Riches v. Hadlock, 80 Utah 265, 15 P.2d 283 (1932).

generally has no implied power to borrow money.[10] However, an early case held that by granting the receiver the power to continue the business, he was impliedly given the power to incur debts, and borrow money for urgent necessities.[11] The New York Court of Appeals has held that a court of equity may authorize the borrowing of money in order to continue the business that is held in receivership and it may expressly state that debts thusly created shall have priority over a pre-existing mortgage.[12] Without authority, the receiver clearly has no right to borrow money and thereby bind the estate.[13] The Bankruptcy Act,[14] provides that such loans may have priority over existing obligations, if in the particular case, the equities demand it, but this special authorization must be shown in the court order. It will not be implied. The controversial point in the instant case is one which is actually well settled, and was succintly expressed in the case of *Shipe v. Consumers Service Co.*,[15] which states that such claims are not entitled to preferred treatment unless the court, by an appropriate order, has given them preferred status. To obtain this priority, creditors must go before the court, *prior* to the loan transaction, and secure the proper order of priority, otherwise their claims are in no different position than those of other general creditors.

In the instant case, the court allows no latitude for the bank's error in failing to require an *express* provision for priority over other costs of administration in the order of the district court which they accepted. Rather, they strictly adhere to the rule which requires averring of priority in order to receive priority, and if otherwise, the loan will be treated merely as another expense of administration.

It is this writer's conclusion that although the rule is well settled, inequities will result, as in the instant case, so long as those dealing with this situation rest complacently on a court order, without first determining whether that order provides for the desired priority.

Thomas M. Coker, Jr.

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10. Blanke v. Blanke Tea and Coffee Co., 124 S.W.2d 568 (Mo. 1939).
11. *In re* Erie Lumber Co., 150 Fed. 817 (S.D. Ga. 1906).
12. Vilas v. Page, 106 N.Y. 439, 13 N.E. 743 (1887) (railroad executed first and second mortgages on its property which was later placed in the hands of a receiver who petitioned court for power to buy necessary rolling stock on credit).
13. Union Trust Co. v. Illinois Midland Ry., 117 U.S. 434 (1886); *In re* American Coller Co., 125 F.2d 496 (2nd Cir. 1942); Amick v. Hotz, 101 F.2d 311 (8th Cir. 1939), *cert. denied*, 307 U.S. 637 (1939); Darling v. Cornstalk Products Co., 54 F.2d 670 (E.D. Ill. 1931); Byrnes v. Missouri Nat. Bank, 7 F.2d 978 (8th Cir. 1925).
14. Bankruptcy Act, Art. 6 § 344, 11 U.S.C. 744.
15. 28 F.2d 53 (N.D. Ind.), *aff'd*, 29 F.2d 321 (7th Cir. 1928), *cert. denied*, 279 U.S. 850 (1929) (Petitioner sold supplies to the receiver to maintain the operation of service stations, and claims expenses of operation, including supplies furnished should be preferred. Court held such expenses can be given priority but only with extreme caution. Receiver's purchase of supplies is notice of insolvent estate, and to gain preference seller must see that court is advised of the purchase and preference given in advance).