

Delaware Custodians, Receivers and Trustees (Oh My!)

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Under Delaware law, the board of directors is generally responsible for overseeing the business and affairs of the corporation. However, where the board is incapable or unwilling to act and in other unique circumstances described below, the Delaware General Corporation Law allows stockholders, directors, creditors and other interested parties to attempt to displace the board's decision-making authority through the appointment of a custodian, receiver or trustee for the corporation.

A custodian, receiver or trustee is a third party who is given authority by a court to act on behalf of the corporation, typically for a limited duration and charged with completing one or more court-defined tasks. While often used interchangeably (including in the statutes), the term "custodian" is usually used to refer to a court-appointed for a solvent corporation, while the terms "receiver" or "trustee" are more often used when the corporation is dissolved or insolvent. Delaware Court of Chancery Rules 148 through 168 provide that a receiver must be a Delaware resident, and set forth certain powers and duties of a receiver. However, the application of those rules (and the Delaware residency requirement) can be waived or modified by the Court of Chancery in appropriate circumstances. For ease of reference, this article uses the general term "receiver" to refer to a receiver, custodian or trustee.

A receiver can be appointed for a solvent corporation under Section 226 of the Delaware General Corporation Law in situations where there has been some failure in the ability or willingness of the board or stockholders to act. Section 226 permits the Court of Chancery, upon application of any stockholder, to appoint a receiver if at a meeting of stockholders, the stockholders are so divided that they fail to elect directors, or the business of the corporation is suffering or threatened with irreparable injury because the directors are so divided that they cannot act and the stockholders are unable to terminate the division. Furthermore, various sections of the Delaware General Corporation Law permit the appointment of receivers for the purpose of carrying out the liquidation of a corporation. For example, under Section 226(a)(3), a stockholder can petition for a receiver where the corporation has abandoned its business and has failed to take steps to liquidate and dissolve within a reasonable amount of time. Under Section 279, a stockholder, creditor, director or any other person who shows good cause can attempt to appoint a receiver for a dissolved corporation. And Section 291 permits creditors or stockholders of an insolvent corporation to petition for the appointment of a receiver to take charge of the assets and debts of a corporation to protect the interests of its stockholders and creditors.

The petitioning party will bear a potentially heavy burden of convincing the court that good cause exists for the appointment of a receiver under the circumstances. Appointment of a receiver under Section 226(a)(1) or (2) generally requires a showing that there is a deadlock amongst the board or stockholders that has persisted for a significant period of time and cannot be resolved through less drastic means. In the context of Sections 226(a)(3) and 291, the displacement of the board's control of the company is potentially more substantial and the Delaware courts have accordingly described receivership in this context as an "extraordinary" remedy that should only be granted where "there exist special circumstances where some real beneficial purpose will be served." Section 279, which permits the appointment of a receiver for a dissolved corporation at "any time" even after the legal existence of the corporation has otherwise terminated, requires that a petitioner show that there is some "unfinished business" of the dissolved corporation that justifies the appointment of a receiver. Even if the threshold statutory showings have been

made, the appointment of a receiver is always a discretionary matter for the court. For example, on numerous occasions the court has declined to appoint receivers for defunct public companies that had clearly “abandoned” their business, in part due to concerns that the receivership process may be used improperly, including to revive the corporation rather than dissolve it or to circumvent federal securities laws.

If the court agrees to appoint a receiver, it will have wide discretion to shape the duties and authority of the receiver to fit the circumstances of a particular case. For example, in *In re Transperfect Global*, a receiver was given broad authority to sell a corporation where two 50-50 stockholders were so irreconcilably deadlocked that the corporation’s business was suffering as a result. On the other hand, in *Giuricich v. Emtrol*, the court appointed an impartial receiver to remedy a director deadlock whose role in the corporation’s everyday business and affairs was to be “kept to a minimum” and who was empowered simply to serve as a tie-breaking vote in certain circumstances. As another example of a more limited receivership, in *In re Krafft-Murphy*, a receiver was appointed by asbestos claimants against a dissolved corporation for the purpose of accessing the corporation’s insurance policies that could be used to satisfy judgments in pending asbestos lawsuits. Thus, Delaware law gives interested parties and the court the necessary flexibility to use the receivership process to address both limited disputes and matters as well as complex business issues, up to and including the sale or liquidation of the corporation.

Once a receiver has been appointed, it must carry out its charge in accordance with the court’s order. Depending on the nature of the receivership, the receiver may be given the authority to provide instructions to corporate officers and to hire outside counsel and advisors to assist the receiver with its efforts. Often, receivers are required to submit periodic reports to the court to provide updates regarding the status of the receivership. The costs and expenses of the receiver will usually be paid by the parties or out of the proceeds of any assets of the corporation sold by the receiver. Once the receiver has completed its work, the court will enter an order discharging the receiver from its responsibilities and terminating the receivership.

Although Delaware law generally follows a director-centric corporate governance regime and relegates stockholders and creditors to using their voting and contractual rights to effect corporate change, the receivership process offers a potential alternative. Courts likely will be unwilling to appoint a receiver when a corporation is operating smoothly, but the receivership process should be given consideration by parties seeking to protect the interests of the corporation as a whole where there has been a breakdown in the normal corporate governance process or where the corporation would not otherwise be able to act for itself.

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