

DELAWARE BUSINESS COURT INSIDER

Receiver's Disallowance of Creditor's Claim Subject to De Novo Review

What should be the standard of review when the Court of Chancery considers an appeal from a receiver's disallowance of a claim pursuant to section 296(b) of the Delaware General Corporation Law? In *B.E. Capital Management Fund LP v. Fund.com Inc.*, C.A. No. 12843-VCL (Del. Ch. Oct. 4, 2017), Vice Chancellor Laster held that a receiver's determination is subject to de novo review and the court has discretion to go beyond the record presented to the receiver by conducting an evidentiary hearing.

By **Barry M. Klayman and Mark E. Felger**

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Subchapter XI of the DGCL provides for the appointment of receivers for an insolvent corporation. Section 291 of the DGCL authorizes the Court of Chancery, on the application of any creditor or stockholder, to appoint one or more persons to be

receivers for an insolvent corporation, to take charge of its assets, business and affairs; to collect outstanding debts, claims and property due the corporation; and to do all other acts which might be done by the corporation and which may be necessary or proper.

Section 295 provides for creditors' proofs of claims to be filed in the office of the Register in Chancery within the time fixed by the procedure established by the rules of the Court of Chancery. Any creditor or claimant who fails to file a timely proof of claim may be barred from participating in the distribution of the assets of the corporation. Section 296 provides for the adjudication of claims by the receiver, and gives the receiver power to examine, under oath, all witnesses "touching the claims" and to pass upon and allow or disallow the claims in whole or in part. Finally, Section 296(b) provides that any creditor or claimant whose claims have been disallowed in whole or in part may appeal to the Court of Chancery which, after a hearing, shall determine the rights of the parties. Court of Chancery Rule 157 states that at the hearing on exceptions to claims, the testimony of witnesses shall be taken in the same manner as provided for in other causes pending in the Court of Chancery.

In *B.E. Capital Management Fund*, petitioner B.E. Capital sought the appointment of a receiver for respondent Fund.com on the grounds that the company had abandoned its business. When the respondent defaulted, the Court of Chancery entered an order appointing a receiver. The receiver commenced to marshal the company's assets, determine its liabilities, and wind up its affairs, and the court set a bar date for creditors' claims.

Nonparty Philip Gentile, who had served as the company's CEO, submitted a claim based on alleged breaches of his employment agreement with the company. The receiver rejected Gentile's claim as time-barred under New York law, the governing law under the employment agreement. Gentile filed a timely notice of appeal to the Court of Chancery.

The initial question posed by Laster was what standard of review should be used to allow or disallow the claim. Should the appeal to the Court of Chancery be *de novo* or on the record? Moreover, what deference, if any, should be given to the determination by the receiver? Laster noted that neither Section 296 nor the Court of Chancery rules specify the standard to be applied or the degree of deference to be given to a receiver's determination, nor was there any authoritative precedent from the Delaware Supreme Court to guide the court.

Laster held that the standard of review on appeal from a receiver's disallowance of a claim pursuant to Section 296(b) should be *de novo*, with the court having the ability to consider additional evidence beyond the record before the receiver. Laster found support for his decision in the common law procedures that predated Section 296, wherein a creditor who wished to challenge a receiver's determination had to move to intervene in the receivership action and then litigate the claim before the court as if it were an ordinary civil proceeding. Under the common law system, the court conducted a *de novo* review on a potentially different record. Section 296 and the related Court of Chancery rules were intended to streamline the process, but did not purport to change the standard of review that applied. Laster also found support for his decision in the standard of review that the Delaware Supreme Court directed trial courts to use when reviewing a master's report, since when a receiver hears testimony and proof and rejects or allows a claim, the receiver's action is closely analogous to that of a master.

Laster included a caveat that his opinion should not be read to imply that the *de novo* standard of review would apply in the context of other decisions by a receiver. For example, where a receiver has exercised the receiver's judgment regarding the business and affairs of a corporation, such as when selling assets or settling a claim, a more deferential standard of review would seem to be warranted. He also noted that decisions appointing receivers frequently establish a standard of review that will govern particular types of actions, citing a Court of Chancery opinion holding that the

decisions of a receiver would be subject to review and reversal by the court only on a showing that the receiver acted in bad faith, in violation of the receiver's fiduciary duties, or clearly outside the scope of the receiver's authority in matters in which the interests of all members were implicated.

As for Gentile's claim, Laster concluded that the receiver correctly determined that Gentile's claim was barred by the statute of limitations, but erred in looking to the choice-of-law provision in the employment agreement and applying New York's statute of limitations directly. Instead, Laster reached the same result by applying the doctrine of laches, using the statutory limitations period as the presumptive period for the laches analysis, attempting a choice-of-law analysis, assuming that New York's limitations period would apply because it was the most generous to Gentile, and finding that the statutory period ran before Gentile filed his claim.

Laster's opinion in *B.E. Capital Management Fund* is significant because it fills a lacuna in the jurisprudence regarding the standard of review in appeals from a receiver's determinations of creditors' claims. At the same time, it leaves open the door for more deferential standards of review in cases involving challenges to other types of decisions by receivers where appropriate.

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