

This article comes from our neighbors to the north, *The Utah Bar Journal*. It is one of the few we have seen dealing with the appointment of Special Masters and Receivers. While you may never have an occasion to appoint either on your own initiative, it might be useful to review this article whenever you're faced with the necessity of initiating such appointment. Or toss it and simply remember it will be available on our website www.receiver.com.

Special Masters, Receivers, and the Duty to Marshal Evidence


I. INTRODUCTION

During the summer of 2004, the Utah Supreme Court was invited to revisit special master law, receiver law, and Utah's duty of marshaling the evidence, in a case of family corporate contention of overwhelming proportions. The defendants contended that the trial court's appointment of an individual to act as an interim CEO, vested with the judicial immunity of a special master, was unconstitutional. The court refused to place form over substance, and did not allow choice of words and technical meaning to outweigh what it believed was in substance a just result. The unique facts in *Chen v. Stewart* probably may not serve as useful precedent for another close corporation's falling out. However, the case has already been cited to explain Utah's strict marshaling standard, and *Chen v. Stewart* is a valuable primer on Utah special master, receiver, and marshaling law.

II. CHEN V. STEWART

A. Facts of the Dispute¹

Court-Appointed Receiver
Real Estate Consultant
Property Manager
Expert Witness
Developer



Richard K. Olsen
Licensed Arizona Real Estate Broker

WWW.TESTIFY.COM
WWW.RECEIVER.COM
Email: rko@cox.net Tel: (602) 216-6600

On January 10, 2001, Jau-Fei Chen ("Dr. Chen"), the youngest of five siblings, filed a lawsuit against her sister, Jau-Hwa Stewart ("Ms. Stewart") bringing to the Court what Chief Justice Christine Durham later characterized as a "particularly vicious dispute." *Chen v Stewart*, 2004 UT 82 ¶5 100 P.3d 1177. Dr. Chen amended the complaint and added E. Excel International, Inc. as a defendant on January 18, 2001. She claimed breach of fiduciary duties, corporate waste, and corporate wrongdoing. The Utah Supreme Court explained, "[o]ver 200 pages of findings of fact and conclusions of law entered by the trial court narrate a tale of intrigue, deceit, and family strife of surprising proportions." *Chen v. Stewart*, 2004 UT 82, ¶2.

Dr. Chen was President of E. Excel, a manufacturer of nutritional supplements and skin care products sold both nationally and internationally. In 1995, Dr. Chen transferred her interest in E. Excel to her three minor children and to her sister, Ms. Stewart. Ms. Stewart, alleging to control 100% of the shares of E. Excel, voted Dr. Chen off the board of directors and replaced her with their mother, Hwan Lan Chen ("Madam Chen"). The new board removed Dr. Chen as president of E. Excel and installed Ms. Stewart as President. Ms. Stewart and Madam Chen

required all of E. Excel's distributors to sign new contracts with E. Excel forbidding any business activity with Dr. Chen. Ms. Stewart also began establishing new distributors to compete with and replace existing distributors, still loyal to Dr. Chen, in violation of the Contracts E. Excel had with existing distributors providing exclusive territories.

At the trial level Fourth District Judge Fred D. Howard issued Dr. Chen's requested temporary restraining order on June 10, 2001, prohibiting Ms. Stewart from creating new competition for E. Excel or taking away any of its current business. While the temporary restraining order was in place, Ms. Stewart and third party defendants allegedly tried to sabotage E. Excel in violation of the order.² Judge Howard removed Ms. Stewart as President of E. Excel.

Judge Howard subsequently appointed Mr. Larry Holman as interim CEO of E. Excel. The order said the CEO could not participate in the case as an active party litigant. When Dr. Chen's counsel noted that their suggested candidates for interim CEO wanted to avoid personal liability for their acts as CEO, the trial court agreed to also designate Mr. Holman as a "special master" so he could have judicial immunity in the proceedings. The court appointed Mr. Holman to be the manager of E. Excel and gave him the judicial immunities and title of special master: "Mr. Holman is given complete executive authority in his role as chief executive officer and special master." In this role, Mr. Holman was authorized to engage in *ex parte* communications with both parties and witnesses.

B. Mr. Holman's Acts as Special Master and Interim CEO

On May 11, 2001, CEO Holman requested powers of a party litigant and "master claims settler." Judge Howard again expanded the powers of the Special Master and authorized him to act as an active party litigant. Judge Howard authorized him to direct and control E. Excel's litigation and possible settlement. Mr. Holman retained litigation counsel to help him as an active party litigant. On June 1, 2001, Judge Howard approved Mr. Holman's decision to enter a Master Settlement Agreement with Dr. Chen and other third party allies, and Judge Howard gave Mr. Holman authority to execute the agreement. The agreement settled all litigation between E. Excel and Dr. Chen. It further settled all of E. Excel's other litigation.³ It also restructured E. Excel, forcing Ms. Stewart, the sister, and Madam Chen, the mother, out of any type of ownership or control. The agreement changed the relationship with the territorial owners, allowing them to manufacture and obtain E. Excel products using their own manufacturer. There was no disinterested party to approve the agreement. Mr. Holman recommended Judge Howard approve the report because Mr. Holman submitted it in his capacity as special master. The trial judge did approve the actions of Mr. Holman, stating "this Court accepts the conclusion of the business judgment made by the Special Master."

Mr. Holman proceeded to authorize E. Excel to file an Amended Cross-Claim/Third Party Complaint and Motion for Preliminary Injunction against Ms. Stewart and Madam Chen. This was the first time Madam Chen was named as a party to the case.

Judge Howard granted a Preliminary Injunction in favor of E. Excel based on 110 pages of Preliminary Injunction findings adopted from the Special Master's findings. Ms. Stewart and Madam Chen were enjoined from worldwide competition in the dietary supplement, herbal, personal care, cosmetic, and hygiene products industries. The special master participated as an active party litigant and invoked the use of Rule 53, Utah Rules of Civil Procedure, in his filings and paperwork. Mr. Holman's attorneys filed summonses, discovery requests, and trial subpoenas expressly as the special master for E. Excel.

C. The Party's Arguments

Before the Utah Supreme Court, Madam Chen and Ms. Stewart argued that a special master with Rule 53 powers could not act as a party litigant. Dr. Chen and E. Excel countered that Madam Chen and Ms. Stewart failed to marshal the evidence. Dr. Chen and E. Excel also argued that the trial judge did not appoint Mr. Holman as a special master, but that his appointment was really that of a receiver. E. Excel and Dr. Chen argued that the appointment of Mr. Holman was first and primarily the appointment of an interim CEO. They argued that the special master language was added only as a means to insure Mr. Holman had judicial immunity, because he needed protection from being sued. Dr. Chen's counsel argued Mr. Holman was the equivalent of a court-appointed receiver. Madam Chen's counsel in its rebuttal explained that "civil litigation, master settlement agreements, and corporate restructuring under the law are left to private parties and not pendente lite officers of the court." Madam Chen argued that if Mr. Holman had been appointed as a receiver, he would have been a receiver pendente lite, and still unable legally to take the actions he took.

III. SUPREME COURT'S DECISION

The Utah Supreme Court was not impressed with Madam Chen's arguments regarding the special master, receiver, and interim CEO law. The court explained, "We reject defendants' attempts to use this ambiguity to undermine the entire substance of the trial court's rulings." The court then held Madam Chen's counsel failed to adequately marshal the evidence.

A. New Position: Court Appointed Interim-CEO

Although it is a "relatively novel use of a court-appointed officer," the court believed Madam Chen's objection to the appointment of an interim CEO had been waived and the court had power to appoint Mr. Holman as interim CEO. "[T]he trial court had equitable authority to appoint an interim CEO with judicial immunity." The court stated that the parties stipulated in a phone conversation on March 5, 2001, that the CEO would be granted judicial immunity. The court acknowledged Madam Chen was not a party at that time, but Madam Chen waived any objections by her behavior.

Mr. Holman's participation in the litigation with judicial immunity was also favorably received by the Supreme Court for two reasons. First, it was similar to the powers of a receiver, and second, he played an integral role in the furtherance of the trial court's ability to adjudicate the case. The court held, "the powers of the interim CEO appointed in the present case are largely identical to those of a receiver..." In the past, courts have appointed receivers to preserve assets when misappropriation of corporate assets by insiders is asserted, to comply with a request from stockholders of a corporation, or to solve dissent among a corporation's managers. An interim CEO with the same powers as of a receiver has been appointed in a bankruptcy proceeding. The court held receivers are allowed to bring lawsuits. The court made no effort to determine what appointment Mr. Holman possessed. The court did not differentiate between a receiver *pendente lite* and a receiver. The court explained:

Defendants contend that even had the trial court appointed Mr. Holman as a receiver, he would have been a 'pendente lite' receiver, with none of the powers allocated to Mr. Holman as interim CEO. We need not decide today whether defendants' distinctions between 'pendente lite' receivers and other types of receivers merits the attention defendants give it. Nor do we need to decide today whether a 'pendente lite' receiver has the powers to run the company in a 'biased fashion' and bring suit. As heretofore stated, the trial court did not appoint a receiver, or even a 'pendente lite' receiver. *Chen*, 2004 UT 82, n.11. The court did not reach the question of special master, and instead focused on judicial immunity: "While the term 'judicial immunity' historically refers to the immunity extended to judges for their official acts, we use it in this unique context as extending to those appointed to act under the court's direction." *Id.* at n. 12. ("[W]e need not consider at this time whether a rule 53 special master could be so empowered.") The court stated, "it is quite clear" there was no overlap of the quasi-judicial function and the court-appointed CEO or receiver function. The court ignored any references Mr. Holman or his counsel made to his being a special master, or invoking rule 53.

B. Marshaling the Evidence

Prior to *Chen*, legal questions were outside Utah's marshaling requirement. However, that standard has now changed. As the Court explained, "if a determination of the correctness of a court's application of a legal standard is extremely fact sensitive, the defendants also have a duty to marshal the evidence." *Chen*, 2004 UT 82, ¶20.

The court in *Chen* took the opportunity to reiterate the standard for marshaling the evidence, explaining that "the requirements of marshaling still do not appear to be understood with the sense of clarity and urgency we desire." The test includes presenting "every scrap of competent evidence introduced at trial which supports the very findings the appellant resists." "In sum, to properly marshal the evidence the challenging party must demonstrate how the court found the facts from the evidence and then explain why those findings contradict the clear weight of the evidence." Even if there is no evidence the trial court could have used to reach its conclusion, the court explained that "an appellee need only point to a scintilla of evidence that supports a court's findings in order to refute an appellant's claim of no evidence." In this case, "[d]efendants have merely ignored damaging findings and avoided confronting problematic facts by claiming there is no evidence." This new standard requires appellants to marshal the entire record, not just the topics on appeal.

C. Observations and Suggestions

The additional language in the opinion regarding special masters, receivers, and interim CEOs may prove to be confusing and unhelpful for future cases. The court's ruling creates a precedent allowing judges to appoint interim CEOs, receivers, or special masters to act as party litigants, with expansive powers, mixed roles and full judicial immunity. This is an extension of judicial power allowing direct access to and control of the day-to-day operations of any ongoing business. Power to appoint interim CEOs is nearly without precedent throughout the nation.

The failure to marshal properly continues to be a millstone around appellants' necks. The Utah Supreme Court should identify briefs where evidence was correctly marshaled. Not only is this a require-

ment unique to Utah, but many experienced attorneys and well known and respected firms have been found to have failed to properly marshal. Attorneys will not be able to understand the requirement of correct marshaling without having examples of such marshaling properly done.

Utah attorneys should be extremely careful in any claim of "no evidence" for an opposing party's proposition. A mere scintilla of evidence, particularly in a voluminous and complicated case, is an easy standard for an appellee to meet.

IV. Appendix: law regarding Special Masters, Receivers, Court Appointed CEO's and Duty to Marshal

A. SPECIAL MASTERS

Special masters are appointed under Rule 53 of the Utah Rules of Civil Procedure. Special masters are appointed by judges to act for the court in conducting hearings, creating findings of fact, and reports. Often they are appointed when litigation is complex and the judge needs someone to help with fact finding. See *In re Worthen*, 926 P.2d 853, 859-60 (Utah 1996). Special masters originated from common law rules of equity authorizing the use of masters in courts of chancery. See *De Clements v. De Clements*, 662 So.2d 1276, 1279 (Fla. Ct. App. 1995). Utah courts have used special masters since the nineteenth century in territorial courts. See *Nephi Irr. Co. v. Jenkins*, 31 P. 986, 987 (1893). These special masters are not allowed to replace the court, but are to assist in judicial functions. See Utah R. Civ. P. 53(a)-(b); *Plumb v. State*, 809 P.2d 734, 742-43 (Utah 1990); *Webster Eisenlohr, Inc. v. Kalodner*, 145 F.2d 316, 319 (3d Cir. 1944).

The language of the federal rule is similar to the Utah rule, and Utah can look to federal precedent in determining special master law. See *Plumb*, 809 P.2d at 740 n.9. A pendente lite special master, meaning one appointed during the pendency of the litigation, can only be empowered with and exercise judicial power. See Utah R. Civ. P. 53; *Webster Eisenlohr*, 145 F.2d at 319; *Plumb*, 809 P.2d at 742-43. The simple rule is to inquire whether or not a judge would be authorized to take the action, and if not, the special master cannot take action. See *Plumb*, 809 P.2d at 743. According to Rules 53 (b), the appointment of a special master should be the exception and not the rule. Special masters are only appointed under Rule 53. See *Turner v. Orr*, 722 F.2d 661, 664 (11th Cir. 1984). The term is a technical one. A special master's immunity is intertwined with his appointment as a special master; he cannot have the immunity without the position. See *Parker v. Dodgion*, 971 P.2d 496, 498 (Utah 1998). Special masters have the duty to raise issues of unlawful empowerment and pendente conflicts of interest. See *Regional Sales Agency, Inc. v. Reichert*, 830 P.2d 252, 257 n.7 (Utah 1992). The judge's intent in appointing a special master is controlling. See *Home Port Rentals, Inc. v. Ruben*, 957 F.2d 126, 132 (4th Cir. 1992); *Lefkowitz v. Fair*, 816 F.2d 17, 22-23 (1st Cir. 1987). The powers of special masters are specifically limited to judicial powers. See *Plumb*, 809 P.2d at 742-44; *LaBuy v. Howes Leather Co.*, 352 U.S. 249, 256 (1957). *Plumb* rejected *LaBuy's* ultimate holding, but confirmed *La-Buy's* rule that a special master is a subordinate judicial officer. As such, special masters are not authorized to participate in litigation as parties, or to participate in ex parte communications. See *Webster Eisenlohr*, 145 F.2d at 319. Additionally, it is improper for a special master to have any loyalties to any of the parties. See *Plumb*, 809 P.2d at 743.

B. THE ROLE OF THE RECEIVER

There are four main types of receivers: 1) a "pendente lite receiver" appointed during the course of litigation, 2) a receiver appointed to hold and preserve assets, 3) a receiver appointed for an insolvent company or to dissolve a corporation, and 4) a statutory receiver or custodian appointed under Utah Code Ann. § 16-10a-1432.4 Receivers are governed under Rule 66 of the Utah Rules of Civil Procedure. The primary purpose of a receiver is to protect the assets and status quo of the property or entity. See *Savageau v. Savageau*, 285 P.2d 810, 813 (Colo. 1955). Utah law allows a court to appoint a receiver "in cases where misappropriation of corporate assets by corporate insiders is asserted." See *Richardson v. Arizona Fuels Corp.*, 614 P.2d 636, 638 (Utah 1980).

A receiver is appointed based on the court's discretion. See *Waag v. Hamm*, 10 F. Supp. 2d 1191, 1193

(D. Colo. 1998); *Richardson*, 614 P.2d at 638 ("In determining whether a receiver should be appointed, the district court should consider the pleadings as a whole."). Where a corporation is solvent, a receiver serves the interests of and owes a fiduciary duty to all parties in interest of the corporation. See *Geyser Min. Co. v. Bank of Salt Lake*, 51 P. 151, 152 (Utah 1897). In such a scenario, a receiver is appointed under the catch-all statement providing for a receiver, "[i]n all other cases where receivers have heretofore been appointed by the usages of court in equity." Utah R. Civ. P. 66(a)(6). The appointment of a receiver should be used as a last resort because it is a drastic remedy. (See *Rosen v. Siegel*, 106 F.3d 28, 34 (2d Cir. 1997).

According to Rule 66(d), a receiver is allowed to participate in lawsuits if he brings the action in his own name. However, the receiver is not an agent of the parties, but of the court, and must be disinterested, impartial, and neutral.⁵ The receiver has an interest that prevents him from acting as a special master because his responsibility is to preserve assets. *United States v. Conner*, 291 F.2d 520, 526 (2d Cir. 1961).

Before a pendente lite receiver may initiate a separate action under Rule 66(e), he must petition the court and be specifically authorized by the court to bring a specific action, and he cannot be given discretion whom to sue. (See *Morand v. Superior Court*, 113 Cal. Rptr. 281, 284 (Cal Ct. App. 1974); *Kist v. Coughlin*, 57 N.E.2d 199, 205 (Ind. 1944). He may not be lawfully empowered to act as a litigation receiver when he is appointed as a pendente lite receiver, because his purpose is to assist the court in securing the parties' rights, not to destroy such rights. See *Case v. Murdock*, 528 N.W.2d 386, 388-89 (S.D. 1995).

A receiver cannot increase or decrease the number of parties to a main action. *Kist*, 57 N.E.2d at 205. Additionally, parties may not stipulate to the appointment of a receiver where a receiver may not be lawfully appointed. *Gatch, Tennant & Co. v. Mobil & O.R. Co.*, 59 F.2d 217, 217-18 (D. Ala. 1932); *Armour Fertilizer Works v. First Nat'l Bank*, 100 So. 362, 365 (Fla. 1927); *Davis v. Hayden*, 238 F. 734, 739-40 (4th Cir. 1916); *Elliot v. Superior Court*, 145 P. 101, 103 (Cal. 1914). The purpose of a receiver is to manage the affairs of the corporation to preserve the parties' rights and maintain the status quo. (*Davis v. Gray*, 83 U.S. 203, 217-18 (1872); *Geyser Mining Co.*, 51 P. at 152. "The receiver is an officer and arm of the court and acts under the direction and supervision of the court." *Interlake Co. v. Von Hake*, 697 P.2d 238, 239-49 (Utah 1985). Under these policies, a receiver "cannot be used simply as a tool for one faction to wrest control of a corporation away from another faction." *Syphers v. Scardino*, 1985 U.S. Dist. LEXIS 13161, *21 (E.D. Pa. Dec. 5, 1985).

A receiver is supposed to take an oath or post a bond to faithfully execute the duties of a receiver. See Utah R. Civ. P. 66(d); *Fed. Trade Comm'n v. World Wide Factors, Ltd.*, 882 F.2d 344, 348 (9th Cir. 1989). The requirement to take an oath or post a bond can be waived. *Neilson v. Dennett*, 450 P.2d 93, 94-95 (Utah 1969); *Travelers Ins. Co. v. Broadway West Str. Assoc.*, 164 F.R.D. 154, 163 (S.D.N.Y. 1995). The business judgment rule also applies to receivers. *Assoc. of Commonwealth v. Hake*, 507 N.W.2d 665, 671 (Neb. Ct. App. 1993); *Golden Pacific Bancorp v. FDIC*, 2002 U.S. Dist. LEXIS 24961 (S.D.N.Y. Dec. 26, 2002).

If the court uses the title of special master, but the appointment is in truth for a receiver, the confusion does not necessarily lead to reversible error. *World Wide Factors*, 882 F.2d at 348. "[W]hatever the title, the court's equitable power to appoint an agent to supervise the implementation of its decrees is not terminated or modified by rule 53." *Chen v. Stewart*, 2004 UT 82 | 54 fn.12, (citing *Jenkins v. Missouri*, 890 F.2d 65, 67 (8th Cir. 1989)).

C. INTERIM CHIEF EXECUTIVE OFFICERS

Bankruptcy proceedings provide the only forum where courts have appointed interim CEOs to serve in overseeing the reorganization of the company. 11 U.S.C. § 1107; *In re Prop. Co. of Am. Joint Venture*, 110 B.R. 244, 245-46 (Bankr. N.D. Tex. 1990); *Cooke v. United States*, 796 F. Supp. 1298, 1300-01 (N.D. Cal. 1992). Relevant statutory provisions define a CEO's scope of authority. In Utah, the Utah Business Corporations Act defines the scope of a CEO's authority. See Utah Code Ann. § 16-10a-831. It

requires that each officer perform duties set forth in the bylaws of the corporation. If a CEO wants to take a certain action, a CEO may do so if it is not in conflict with the bylaws and the directors authorize the CEO to so act.

Chief Executive Officers lack standing to bring claims for injuries to the corporation in their own names. (See *Lui Ciro, Inc. v. Ciro, Inc.*, 895 F. Supp. 1365, 1380 (D. Haw. 1995); *Willis v. Lipton*, 947 F.2d 998, 1000-02 (1st Cir. 1991); *Hite v. Bell Atlantic Corp.*, No. CV-98-0981, 2000 U.S. Dist. LEXIS 5310, at 8 (M.D. Pa. 2000).) This is because a CEO is only indirectly injured when a corporation is injured.

As of January 2005, there was only one case found where a CEO was appointed by the court in a proceeding not involving bankruptcy. See *Brooks v. United States*, No. 92-3295 1994 U.S. App. LEXIS 20616 at 4-5 (10th Cir. 1994). In that case, the court acceded to the requests of the corporation who wanted a CEO rather than a receiver to prevent the loss of oil and gas concessions, which would have been cancelled upon the appointment of a receiver.

D. THE DUTY TO MARSHAL

Utah puts the burden on the appellant to marshal the evidence. See *Chen*, 2004 UT 76; Justice Michael J. Wilkins, A Primer in Utah State Appellate Practice, 2000 Utah L. Rev. 111, 127-28. By marshaling, the appellant is required to "list all the evidence supporting the findings and then demonstrate that the evidence is inadequate to sustain the findings" Justice Wilkins, A Primer in Utah State Appellate Practice, 2000 Utah L. Rev. at 127. Marshaling the evidence requires "[t]he challenger to present, in comprehensive and fastidious order, every scrap of competent evidence introduced at trial which supports the very findings the appellant resists." *Neely v. Bennett*, 2002 UT App 189, ¶ 11, 51 P.3d 724. Justice Wilkins of the Utah Supreme Court likens the process to becoming a "devil's advocate" by presenting all the evidence upon which the trial court relied. Additionally, if the problem arises that the findings of fact are not there, counsel should argue that the findings are legally insufficient. See Justice Wilkins, Utah Appellate Practice, 2000 Utah L. Rev. at 128.

Justice Wilkins provides three policy reasons why marshaling the evidence is good. First, it reminds appellate courts that the trial court, as fact finder, deserves deference. Second, it increases the appellate court's efficiency in writing and deciding cases, because the appellant provides all the material necessary for the court to see the potential flaws. Third, marshaling is the duty of the appellant because he or she bears the burden of not deferring to the trial court.

1. These facts are taken from the Brief of Appellant Madam Chen, the Brief of Appellant Jau Hwa Stewart, the Opposition Brief of Appellee E. Excel, the Reply Brief of Madam Chen, and the Reply Brief of Jau Hwa Stewart.
2. Brief of Appellee E. Excel at 13. A story is told that Ms. Stewart and third party defendants destroyed tons of E. Excel product, then bought mice from pet stores and released them into the factories, claiming because of the mice infestation the product was gone.
3. See Brief of Appellant Madam Chen at 18. This settlement included a Hong Kong derivative action filed against Dr. Chen and her allies, alleging they embezzled \$75 million of E. Excel revenue.
4. See Reply Brief of Hwan Lan Chen at 11, *Chen v. Stewart*, 2004 UT 82, 100 P.3d 1177 (citing *Stokes v. Hoffman*, 46 A.D. 120, 128, 132-33 (N.Y. App. Div. 1899)); *Valley View State Bank v. Owen*, 737 P.2d 35, 38-39 (Kan. 1987).
5. See Utah R. Civ. P. 66(b); *Ledbetter v. Farmers Bank & Trust Co.*, 142 F.2d 147, 150 (4th Cir. 1944); *Booth v. Clark*, 15 L. Ed. 164, 168 (1854); *Geyser Mining Co. v. Bank of Salt Lake*, 61 P. 151, 152 (Utah 1897); *Norwest Bank Nebraska v. Bellevue Bridge Comm'n*, 607 N.W.2d 207, 210 (Neb. Ct. App. 2000).