The Trust Fund Theory of the Assets of Insolvent Corporations.
When Mr. Justice Story handed down his opinion in the case of Wood v. Dummer, (1) he established a new doctrine in the law of corporations. This case seems to be the first reported one that goes to the extent of saying that the assets of an insolvent corporation are a trust fund for the benefit of the corporation creditors, though there are a few scattered cases previous to this one that go so far as to hold such funds to be trust funds to a more or less limited extent. (2)

After discussing the facts of the case, Mr. J. Story advances the following arguments in support of the principle which he lays down: "It appears to me to be very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank. The public, as well as the legislature, have always supposed this to be a fund appropriated for such purposes. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility and substitutes the capital stock in its stead. Credit is universally given to this fund by the public as the only means of repayment. During the existence of the corporation it is the sole property of the corporation, and can be applied only according to its charter, that is, as a fund for the payment of its debts, upon the credit of which it may discount and circulate notes. Why, otherwise, is any capital stock required by our charters? If the stock may, the next day after it is paid in, be withdrawn by the stockholders without payment of the debts of the corporation, why is its amount so studiously provided for, and
its payment by the stockholders so diligently required? To me this point appears so plain upon principles of law, as well as common sense, that I cannot be brought into any doubt that the charter of our banks make the capital stock a trust fund for the payment of all the debts of the corporation. The billholders and other creditors have the first claims upon it; and the stockholders have no rights until all the other creditors are satisfied. They have the full benefit of all the profits made by the establishment, and cannot take any portion of the fund until all the other claims on it are satisfied. Their rights are not to the capital stock, but to the residuum after all demands on it are paid. On a dissolution of the corporation the billholders and the stockholders have each equitable claims, but those of the billholders possess, as I conceive, a prior exclusive equity. (3)

If I am right in this position, the principal difficulty in the case is overcome. If the capital stock is a trust fund, then it may be followed by the creditors into the hands of any person having notice of the trust attaching to it. As to the stockholders themselves, there can be no pretence to say that both in law and fact they are not affected with the most ample notice.

The doctrine of following trust funds into the hands of any persons who are not innocent purchasers, or do not otherwise possess superior equities, has been long established. Lord Redesdale, in Adir v. Shaw, (4) lays it down in very broad terms. He says: "If we advert to the cases on this subject, we shall find that trusts are enforced, not only against those persons who rightfully are possessed of the trust property as trustees, but also against all per-
sons who come into the possession of the property bound by the
trust with notice of the trust; and whoever comes so into possess-
ion is considered as bound with respect to that particular proper-
ty to the execution of the trust." And a very strong recognition,
as well as application of the principle will be found in Taylor v.
Plummer, (5) even in courts of common law. On this ground assets dis-
posed of by executors by misapplication, or existing in the hands
of debtors, when the executor is insolvent, or there is collusion,
are often reached in favor of creditors as a trust fund. (6) The ca-
ses of partnership also furnish a very strong analogy. There, in eq-
uity, partnership funds will be followed in favor of creditors
into the hands of third persons. It is true, as the Master of Rolls
said in Campbell v. Mullet, (7) the equities of creditors are to be
worked out through the medium of partners. They have no lien, but
something approaching to a lien, which courts of equity will regard
and enforce in all cases where superior rights, which ought to be
protected, do not intervene. (8) It is not, however, necessary to search
for analogous cases, for upon the plain import of the charter, the
capital stock is a trust fund for creditors, and the stockholders,
upon the division, take it subject to all equities attached to it.
They are to all intents and purposes, privies to the trust, and
receive it cum onere."

This may be said to have become the doctrine of American Courts.
In Curran v. Arkansas (9) this view is sustained, the court holding
that upon general principles of law a creditor of an insolvent
corporation can pursue its assets into the hands of all other per-
sons, except bona fide creditors or purchasers.
In Henry v. Ry. Co. (10) the court follows the general rule and decrees that the stockholders of the corporation are bound to pay the balance of their stock subscription to insure the payment of the debts of the insolvent corporation.

The case of Slee v. Bloom (11) seems to go to the extreme, holding the defendants personally liable on the following case; In December, 1814, the defendants became a corporation to expire in twenty years. Subsequent to December, 1817, there was no meeting of the trustees, nor any business done by the corporation; and in February, 1818, the property of the corporation, both real and personal was sold at a sheriff's sale. It was held, in an action brought in April, 1819, by a creditor of the corporation, against the stockholders, to charge them individually for the debt of the corporation, in proportion to their relative shares of stock, that they were liable, the corporation having been dissolved by reason of its ceasing to act as such, and by reason of the sale of all its property. The court does not commit itself as to whether different circumstances as to the means of termination would alter the judgment or not.

The same rule is strictly adhered to in Adler v. Brick Co. (12) the court regarding the capital stock of a corporation, both that which has been actually paid in and that which remains unpaid, as a trust fund pledged for the payment of the debts of the corporation. The general Wisconsin doctrine can be gathered from the several cases and summed up as follows: A judgment creditor of a corporation, after execution returned unsatisfied, may maintain an action in his own behalf and in behalf of such other
creditors of the corporation as may elect to become parties there to, against the corporation and its delinquent or withdrawing stockholders, and have a decree that an account of the assets and debts of the corporation be taken, and a receiver appointed. And that the stockholders and officers of the corporation pay in and account to the receiver for so much of the capital stock as will be sufficient to pay the debts of the plaintiff, and of such other creditors as may choose to join with him and come in under the decree, and that the receiver apply the same in discharge of such debts. (13)

Among the leading cases in the various federal and state courts that sustain this doctrine to a greater or less extent are:

The English rule is similar to the American one to the extent of holding that the creditors of a corporation must be paid before its property can be distributed among its shareholders. This is the same rule as that of partnerships; the partnership
creditors must be paid before the assets can be divided up among the partners. And, if we look upon the shareholders as proprietors, or even partners, and this seems to be the only practical conception of their status, the rule is the same as that applied to every other debtor; he cannot keep and enjoy his property leaving his debts unpaid.

The American cases which declare and apply this rule go much further than this. They mean that the directors and other officials who have charge of the property of the corporation are in a sense trustees of the creditors of the corporation. Some of these cases have even gone so far as to make them personally liable at the suit of creditors, for misapplication and waste of corporate assets.

Even the case of Wood v. Dummer and the cases therein cited by Mr. Justice Story would not so indicate, it would seem that the American doctrine on this subject had its origin in the English courts, where the rule has long been established that the property of a charitable corporation is a trust fund, and as a trust fund the courts of chancery have it in charge and have jurisdiction over its custodians as trustees.

The late case decided in an English court, cited as Poole’s case (15) defines the position of the English chancery courts on the question, and in it the doctrine of the American courts is directly denied. In this case three directors of a company, who had not been called upon to pay anything upon their shares, made themselves liable upon their personal guaranty for money advanced to the company by the bank. The company got into difficulties, and the bank recovered a judgment against the directors on their guaranty.
they are liable to make good their breach of trust to their cestui qui trust like any other trustees. But the directors are not trustees for the creditors of the company. The creditors have certain rights against a company and its members, but they have no greater rights against the directors than against any other members of the company. They have only statutory rights against the members which are given them in the winding up act."

This rule applies to all of the subscribed stock of the corporation, whether it is paid up or not. In other words, the American Equitable doctrine is that the capital stock of a corporation is the resource on which the corporation obtains credit. This capital stock may be looked upon as: 1. Money which has been subscribed and paid in. 2. Money subscribed toward the capital stock but not paid in. 3. Dividends improperly declared, as from the capital stock, and which are improperly divided among the members of the corporation, leaving the debts of the corporation unpaid.

In carrying out this rule the Supreme Court of Alabama, in Curry v. Woodward, held that it was held to be fundamental, as a part of this doctrine, that shareholders who have subscribed for the capital stock but not paid for the same, as to the unpaid balance of their subscription, constructive trustees for the creditors of the corporation. Georgia and Mississippi have gone even further than this and held that such stockholders are express trustees for such creditors, and, as the Mississippi court says, "a continuing and subsisting trust and confidence, to which the statute of limitations has no application". This would seem as though the statute of limitations would not run in favor of the stockholders and against the creditors, until the corporation has been dis-
solved or ceased to do business.

From the way in which this view looks upon the capital stock of the corporation, both subscribed and paid up, the question would arise as to whether the corporation would have the power of entering into an agreement with the stockholders and consider this unpaid subscription, which is the Trust Fund under this theory, as an ordinary debt. Sawyer v. Hoag, (22) is the earliest and leading case on the subject. In it it was held that the trust theory of the corporate stock could not be defeated by a simulated payment of the stock subscription, nor by anything short of actual payment in good faith.

In this case an agreement had been made by which the stock was nominally paid, though the stockholder immediately took the same as a loan to him. This was merely a device to change the debt from a stock debt to a loan, and was not a valid payment as against creditors of the corporation. A stockholder who is indebted to an insolvent corporation for unpaid shares cannot set off against this trust fund for creditors a debt due him by the corporation. The fund arising from such unpaid shares must be equally divided among all of the creditors.

It would seem for the same reasons, beyond the power of the corporation to divide its capital stock and assets among its stockholders leaving its debts unpaid. Every stockholder who received a portion of the capital stock on such distribution, is liable in equity for his pro rata share to the discharge of the debts of the corporation out of the funds in his hands. (23) This pro rata contribution does not extend so far, however, as to require stockholders to surrender, for the benefit of the creditors, bona fide dividends.
of profits which were declared and distribution at a time when the company was solvent and prosperous. (24) There can be no question as to the equity of this rule, as all of the cases join in holding that the profits and accretions springing from the use of the capital stock of a corporation form no part of the capital stock itself, but a separate and distinct fund or profit, and cannot be claimed to be any part of the stake on which the corporation acquires credit. (25) All persons doing business know that these profits are always subject to distributions in dividends at the will of the directors.

It is really immaterial whether or not this surplus is divided. When the corporation is solvent it would, it is true, be subject to attachment and be a fund for the payment of creditors, but if the corporation is in such a condition that it has such a large surplus on hand, it is highly probable that it would be able to pay all obligations. If, on the other hand, such surplus be divided on account of approaching insolvency, the creditors can follow the same and the stockholders will be required to refund it. For, when a corporation becomes insolvent, all of its assets, not its capital stock alone, become impressed with the character of a trust fund for the security of its creditors.

There is no question but that the view of most of the American Courts, upheld by numerous authorities, adhere to the view that whoever subscribes to an unconditional agreement to take shares of stock in the corporation becomes liable to pay for them, subject only to the conditions that are given in the subscription paper, and any that may be imposed by the charter or the general law. (26) A man has the same right in this instance to make a condi-
tional contract is in any other, and if the subscription is conditional, and so appears in the contract, until the condition is performed there id no contract, and a stock subscriber cannot be held liable as a stockholder. (27) No action can be brought against such conditional subscriber until he has had notice that the conditions have been performed (28). This condition may be waived by the subscriber, however, as by paying an installment, (29) voting the stock at an election or serving as an officer of the corporation. (30)

This capital stock of which we have been speaking, consists of money paid, or authorized or required to be paid in, as the basis of the business of the corporation and the means of conducting its operations. Mr. Justice Swayne, in Farrington v. Tennessee, (31) said: "The capital stock is the money paid or authorized or required to be paid in as the basis of the business of the bank, and the means of conducting its operations. It represents whatever it may be invested in. If a large surplus is accumulated and laid by, that does not become a part of it. The amount authorized cannot be increased without proper legal authority. If there be losses which impair it, there can be no formal reduction without like sanction. No power to increase or diminish it belongs inherently to the corporation. It is a trust fund, held by the corporation as trustee. It is subject to taxation like other property. If the bank fail, equity may lay hold of it, administer it, pay the debts, and give the residuum, if there be any to the stockholders. If the corporation be dissolved by judgment of law, equity may interpose and perform the same functions."

It is an essential part of the trust fund doctrine that the money agreed to be paid into the corporate treasury by the share-
holders for their respective shares is a part of this trust fund. When the liquidation of these unpaid subscriptions becomes necessary to pay the debts of the company, the stockholders cannot be allowed to refuse the payment of them, unless they show such an equity as would entitle them to a preference over the creditors, if the capital had been paid in cash. In Oglivie v. Ins. Co., (32a) the rule was laid down, that the stock subscribers could be forced to contribute to the extent of their unpaid subscriptions to the creditors of the corporation in discharge of its debts.

It was formerly the doctrine of the Supreme Court of the United States that this trust fund theory extends to whatever sum, less than the par value of his shares, the shareholder ought to pay, though it may have been agreed between him and the corporation that he should not pay it. Any other case than where the rights of creditors are concerned, this seems to be a reasonable rule, as it goes on the ground that where the corporation agrees to accept less than the full par value of the stock in discharge of the full indebtedness, it is estopped from maintaining an action to collect the balance. This rule was first laid down in the case of Kenton Furnace Co. v. McAlpine, (33) and has been strictly adhered to. Upton v. Tribilcock, (34) laid down the rule that the original holder of stock in a corporation is liable for unpaid installments of stock, without an express promise to pay for them; and a contract between a corporation, or its agents, and him, limiting his liability therefore, is void, both as to the creditors of the company and its assignee in bankruptcy. But this doctrine has been modified by the Supreme Court to the extent of holding that, in absence of circumstances creating an equitable estoppel in favor of the creditor of
the corporation and against the shareholder, the latter cannot be compelled to pay, even for the purpose of liquidating the debts of the corporation after its insolvency, anything beyond what the corporation agreed with him to accept as full payment. This is tantamount to holding that so far as the right of creditors, who became such prior to the issuing of the shares, are concerned, whatever the corporation agreed with the shareholder to accept as payment is payment, even though it agreed to give away the shares or to issue them as a bonus, or in consideration of some past benefit, it is to be deemed payment. This lifts the obligation of the shareholder to pay the par value of the amount of his share, even for the purpose of liquidating the debts of the corporation, out of the category of principles of public policy, and lets it down to the mere doctrine of an equitable estoppel. The meaning is, that in cases where creditors have been deceived and misled by the corporation pretending to have capital which it has not, a creditor can enforce no right as against a shareholder greater than the corporation itself could enforce against him. It is a necessary part of the doctrine that the capital stock of a corporation is a trust fund for all of its creditors,—that is, for a ratable distribution among all of its creditors who stand on an equal footing; as in a distribution in bankruptcy, preserving to lien creditors their liens, and distributing the remainder among the unsecured creditors pro rata.

The final summing up of the trust fund theory may be put in a few words. It would seem that the courts adhering to this doctrine join in holding all of the assets of the corporation, including the tangible as well as the intangible, as choses in action, unpaid cap-
ital stock subscriptions, as a trust fund for the benefit of the creditors of the corporation. And that the directors, as the managing board, as well as the stockholders, are trustees, and the assets a trust fund, for the benefit of all the creditors of the corporation. And as a necessary part of the theory that the assets are a trust fund, the majority of the same courts hold that the directors do not have the power to prefer particular creditors, but that all must share equally.

It is in the power of the preference of creditors that the lever that tends to break up the trust fund theory enters into the law of corporations. A concession of this power seems to sweep the trust fund theory entirely out of existence, and to place the assets of the corporation, in respect to the rights of its creditors, in the same position as the assets of a natural person.

Hopes v. Northwestern Manf. Co., (35) was a proceeding by Hopes and Wordeman praying that the property of the Northwestern Manuf acturing and Car Company be sequestered and a receiver be appointed therefor. Such receiver was appointed and given possession of the property. Thereafter, on September 9, 1884, an order was made, requiring the creditors of the corporation to exhibit their claims within six months and become parties to the proceedings. The Minnesota Thresher Company, a corporation, acting under the order last named, presented a claim against the insolvent corporation, and by leave of the court filed a supplemental complaint therein on behalf of itself and other creditors of the insolvent corporation, and against one hundred and more persons, holders of the common stock of the insolvent corporation, to compel them to pay to the receiver the face value of such stock, on the ground that it had been
issued to them without any payment whatever therefor. A demurrer was
interposed to this supplemental complaint and was overruled, and
thereupon the defendant appealed to the supreme court.

Seymour, Sabin and Company, on May 10, 1882, owned property to the
value of several millions of dollars, and a business then supposed
to be profitable; that in order to continue and enlarge this busi-
ness, the parties interested in S.S.&Co., with others, organized a
car company, to which was sold the greater part of the assets of
S.S.&Co. at a valuation of two millions two hundred and sixty-sev-
en thousands of dollars, it being then and there agreed by both
parties that this stock was in full payment of the property thus
purchased. It is further alleged that the stockholders of S.S.& Co.,
and the other persons who had agreed to become stockholders in
the car company, were then desirous of issuing to themselves, and ob-
taining for their own benefit, a large amount of common stock of
the car company, "without paying therefor, and without incurring
any liability thereon or to pay therefor"; and for that purpose,
and "in order to evade and set at naught the laws of this state,"
they caused S.S.& Co. to subscribe for and agree to take common
stock of the car company of the par value of one million five hun-
dred thousand dollars; that S.S.& Co. thereupon subscribed for that
amount of stock, but never paid therefor any consideration whatso-
ever, either in money or in property; that thereafter these persons
causeditstocktobeissuedtoD.M.Sabinastrustee, to be by
him distributed among them; that it was so distributed, without re-
ciept by him or the car company, from anyone, of any consideration
whatever, but was given by the car company and received by these
parties entirely "gratuitously." The car company was, at this time,
free from debt, but afterwards became indebted to various persons in the sum of about three millions of dollars. The Thresher Company, incorporated after the insolvency and receivership of the car company, for the purpose of securing the possession of its assets, property, and business, and therewith engaging in and continuing the same kind of manufacturing, prior to October 27, 1887, purchased and became owners of the unsecured claims of the various creditors against the car company, "bona fide, and for a valuable consideration, to the aggregate amount of one million, seven hundred and three thousand dollars. As creditors standing on the purchase of these debts which were contracted after the issue of this bonus stock, the Thresher Company files this complaint to recover the par value of this stock as having never having been paid for.

The complaint does not allege what the consideration for these debts was, nor to whom originally owing, nor what the intervener paid for them, nor whether any of the original creditors trusted the car company on the faith of this original stock, bonus as it was, having been paid for. Neither does it allege that either the Thresher Company or its assignors were ignorant of the bonus issue of the stock, nor that they, or any of them, were deceived or damaged in fact by such issue, nor that the bonus stock was of any value. Neither is there any traversable allegation of any actual fraud or intent to injure or deceive creditors. A desire to get something without paying for it, is not fraudulent or unlawful, if the donor consents, and no one else is injured by it; and the general allegation that it was done "in order to avoid and set at naught the laws of the state" of itself amounts to nothing but a conclusion of law. As a creditors bill, in the ordinary sense, the complaint is manifestly insufficient.
The Thresher Company, however, plants itself upon the so called "trust fund" doctrine, that the capital stock of a corporation is a trust fund for the payment of its debts; its contention being that such a "bonus" issue of stock creates, in case of the subsequent insolvency of the corporation, a liability on the part of the stockholder in favor of the creditors to pay for it, notwithstanding his contract with the corporation to the contrary.

The court goes on and reviews the various cases in support of this doctrine, all of which have been considered or cited in this paper. Further on the opinion continues with original matter:

"Another proposition which we think must be sound is, that creditors cannot recover on the ground of contract when the corporation could not. Their right to recover in such cases must rest on the ground that the acts of the stockholders with reference to the corporate capital constitutes a fraud on their rights. We have here a case where the contract between the corporation and the takers of the shares was specific in that the shares should not be paid for. Therefore, unlike many of the cases cited, there is no ground for implying a promise to pay for them. The parties have explicitly agreed that there shall be no such implication by agreeing that the stock shall not be paid for. In such a case the creditors undoubtedly may have superior rights to those of the corporation, but these rights rest on the implication that the shareholder agreed to do something directly contrary to his real agreement, but must be based on tort or fraud, actual or presumed. In England, since the act of 1867, there is an implied contract created by statute that "every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole
thereof in cash. "This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for every one would be advised of its provisions, and could conduct himself accordingly. And in view of the fact that "watered" and "bonus" stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on the grounds of public policy, be very desirable. But this is a matter for the legislature and not for the courts. We have no such statute; and even the law of 1873, under which the car company was organized, impliedly forbids the issue of stock not paid for, the result might be, that such issue would be void as ultra vires, and might be cancelled, but such a prohibition would not of itself be sufficient to create an implied contract, contrary to the actual one, that the holder would pay for his stock.

It is difficult, if not impossible, to explain or reconcile these cases upon the "trust fund" doctrine, or, in the light of them, to predicate the liability of the stockholder on that doctrine. But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of a corporation and the relation which its stockholders bear to it and to the public, we have at once a rational and logical ground on which to stand. The capital stock of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of its capital stock. They have a right to assume that it has been paid in to the corporation and represents capital as the amount claimed by the corporation, and represents itself as having, and if they give it credit on the faith of that representa-
tion is false, it is a fraud upon them, and in case the corporation becomes insolvent, the Law, upon the plainest principles of common justice, says to the delinquent stockholder, "Make that representation good by paying for your stock." It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is misrepresentation of fact in stating that the amount of the capital is greater than it really is that is the true basis of the stockholder in such cases; and it follows that it is only those creditors who have relied upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holder of "bonus" stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies into which the "trust fund" doctrine has involved it, and we think that even when the "trust fund" doctrine has been invoked, the decision in almost every well considered case is readily referable to such a rule.

It is urged, however, that if fraud be the basis of the stockholders liability in such cases, the creditor should affirmatively allege that he believed that the bonus stock had been paid for, and represented so much actual capital, and that he gave credit to the corporation on the faith of it; and it is also argued that while there may be a presumption to that effect in the case of subsequent creditors, this is a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. The proposition is very plausible, and at first sight would seem to have much force; but we think that it is unsound. Certainly, any such rule of pleading or proof would work very inequitably in practice. Insomuch that
as the capital stock of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the matter of faith of that standing and reputation, although, as a fact, he may have no personal knowledge of the amount of the professed capital, and in a majority of cases, knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditors against the holders of such "bonus" stock, they could not truthfully allege, and could not affirmatively prove, that they believed that the defendant's stock had been paid for, and that they gave the corporation credit on the faith of it, although, as a matter of fact, they actually gave the credit on the faith of the financial standing of the corporation, which was based upon the apparent and professed amount of capital.

The misrepresentation as to the amount of capital would amount to a fraud on such creditors as fully and effectively as if they had personal knowledge of the existence of the defendant's stock, and believed it to have been paid for when they gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the creditors are subsequent purchasers; and that if the fact that they dealt with the corporation with the knowledge of the arrangement by which the "bonus" stock was issued, this is a matter of defense.

In one respect, however, we think that the complaint is clearly insufficient. The Thresher Company is here asking the interposition of the court to aid in enforcing an equity in favor of creditors against the stockholders, by declaring them liable to pay for this.
stock, contrary to their actual contract with the corporation. While the proceeding is not, strictly speaking, an equitable action, yet the relief asked is equitable in its nature. Under such circumstances, it was incumbent upon the Thresher Company to show its own equities, and that it was in a position to demand such relief. It was not the original creditor of the Car Company, but the assignee of the original creditors. By that purchase, it, of course, succeeded to whatever strictly legal rights its assignors had; but they are not rights of that kind which they have been seeking to enforce. Under such circumstances, we think it was incumbent upon it to state what it paid for its claims, or at least that it paid a substantial, and not a mere nominal, consideration. The only allegation is that it paid a "valuable consideration". This might have been only one dollar. It appears that it bought the claims after the company had become insolvent, and its affairs in the hands of a receiver; also, that the indebtedness of that company amounted to three millions of dollars, and that there were not corporate assets enough to pay any considerable portion of it. The mere chance of collecting something out of the stockholders does not ordinarily much enhance the selling price of claims against an insolvent corporation. If any person had gone to work and bought up for a mere song this large indebtedness of the Car Company for the purpose of speculating on the liability of the stockholders, no court would grant them the relief here prayed for. It would say to them: "We will not create and enforce an equity for the benefit of any such speculation."

Counsel for the respondent suggest that the Thresher Company is but an organization of the original creditors of the Car Company, who formed it, and pooled their claims, so as to save something out
of the wreck of the Car Company; but nothing of the kind is alleged. On this ground the demurrer should have been sustained.

In view of further proceedings it may be proper to say that, in our opinion, there is nothing in the proposition that the right of recovery against the stockholders was barred by the statute of limitations. The arguments in favor of the proposition all rest upon the false premise that the cause of action accrued in May, 1882, when the bonus stock was issued. The corporation never had any cause of action against these defendants. As between them and the corporation, the agreement for the issue of the stock was valid. The creditors are not here seeking to enforce a right of action acquired through or from the corporation, but one that accrued directly to themselves, or for their benefit, and did not accrue at least until the corporation became insolvent, in May, 1884.

The numerous outside questions, particularly those of pleading, which come up in this case, carries it away somewhat from the question which we have under consideration, but there is really no question but that it finally does away with the trust fund theory as far as this court is concerned. The logic and reasoning in the opinion seem to be based upon good ground, but whether or not the precedent established is equitable is questionable. There is no doubt, however, but that the case has been followed in the Minnesota courts, and that the trust fund theory has no foothold in the courts of that state.

The general rule, however, as to the power to issue fully paid up certificates of stock for but part of the consideration recited, may be summed up as follows, and is sustained by many authorities. The trust fund doctrine implies that a stockholder will not be
permitted, as against creditors of the corporation, to withdraw any part of its assets without a valuable consideration. (36) Nor have the directors, as trustees of this fund, any power, except in the way of bona fide compromises, to release a subscriber to the fund, either as against creditors or as against other stockholders. (37) Thus, if the holder of shares makes an arrangement with the company, by which he receives full-paid script for a part of his subscription, and is released as to the residue, he may be held by the creditors to the obligation of paying in full according to his original undertaking. (38)

So, if a corporation issues new stock under a scheme by which sixty per-cent of its par value is to be accepted as full payment, the shareholder will be bound to make good the other forty per-cent in case of its insolvency. (39) So, creditors may charge the stockholders in respect to dividends fraudently declared and paid when there is nothing to divide; (40) but dividends declared and paid in good faith out of the earnings of the corporation, which is solvent and prosperous, cannot be pursued in the hands of its stockholders by its creditors, when, in consequence of misfortune, it afterwards becomes insolvent, and subjected to its liabilities. (41) An opinion delivered by Jessel, M.R., embodies a forcible expression of the same doctrine. He was dealing with the right of creditors in an insolvent corporation, represented by official liquidators, for their benefit, certain sums which the directors had caused to be paid to the shareholders as interest, out of the capital of the corporation, there being no profits. In his view: "the substance of the right" was this, "The limited Company trades upon the representation of being a limited company, with a paid up cap-
ital to meet its liabilities. It is wholly inconsistent with that representation that the company, having its capital paid up, should pay it back to its shareholders, and give its creditors nothing at all." (42)

The other side of this widely discussed question is supported by many authorities that only go so far it may be said, as a rule, as to hold that an insolvent corporation has the right to prefer creditors. There are quite a number of cases where this rule is both equitable and right, but the gradations to what practically amounts to fraud, make it difficult, if not impossible, to draw a line where the reaction amounts to an injustice and imposition on one party or the other.

John V. Farwell Company v. Sweetzer, (43) is a good example of this condition of affairs. The dictum of the court in this case sums up the law in a few short phrases. "The assets of an insolvent corporation constitute a trust fund for the benefit of creditors, only as between creditors and stockholders, and do not constitute a trust fund for ratable distribution among all of its creditors; and hence such a corporation may prefer a creditor by conveying to him all of its property in good faith."

Briefly stated the facts of the case were about as follows: In 1895 the Paul Wilson Dry-Goods Company was a corporation doing business in the city of Pueblo. On the 27th day of February of that year, this corporation executed a chattel mortgage on all of its stock in trade and fixtures to the American National Bank of Pueblo and Sweetzer, Pembroke and Company, a copartnership, and assigned to the same parties all of its book accounts. The mortgage and assignment were made to secure an indebtedness to those par-
ties aggregating to a sum of $25,563.31, exclusive of interest. The mortgage, by its terms, authorized the mortgagees to take immediate possession of the stock of goods and fixtures, and to sell the same at private or public sale, for the purpose of satisfying the indebtedness, rendering and paying the overplus, if any, to the dry-goods company. The mortgagees thereupon took possession of the mortgaged property, and caused it to be inventoried, the inventory showing the approximate value to be about $35,059.32. At the time of the transaction the dry-goods company was indebted to the John V. Farwell Co. and Carson, Pirie, Scott and Co. in sums amounting in a total of $7,037.59 and to other parties to a considerable amount. The Wilson Dry-Goods Co. was in a failing condition, if not actually insolvent. After the making of the mortgage and assignment mentioned the Farwell Co., Carson, Pirie, Scott & Co., and other creditors instituted proceedings in attachment against the dry-goods company and caused the mortgagees to be summoned as garnishees. The Farwell Co. and C.P.S. & Co. then brought this action against the mortgagees and the mortgagor to set aside and cancel the mortgage and assign the property to the payment of the claims of the plaintiffs and the other creditors, alleging that the property transferred composed all of the assets of the insolvent corporation; and that the value of the property transferred was largely in excess of that corporation's indebtedness to the mortgagees; that, at the time the mortgage and assignment were given, the mortgagees knew that the corporation was insolvent; that the execution of the mortgage and assignment prevented the dry-goods company from carrying out the purposes of its organization and incorporation, and had the effect of working a dissolution of the corporation in a way other than that provided
by law; that the indebtedness was past due, and was one for which the stockholders and directors of the company had made themselves personally liable, and that the transaction was one that resulted from a fraudulent collusion between the mortgagor and the mortgagees to hinder and delay the plaintiffs and the other creditors of the mortgagor in the collection of their claims. The property described in the mortgage was sold for $31,000. The nominal value of the book accounts seems to have been something in excess of $14,000. Concerning their real value, what of them were collectible, and what not, and what became of them, the records afford no information. It clearly appears from the evidence that all of the parties of the transaction acted in good faith; that its sole object was to secure a bona fide indebtedness, for which no personal liability had been incurred by the directors or stockholders, and that there was no improper purpose in the suggestion or consummation of the transaction on the part of anyone connected with it. There is, therefore, no question of actual fraud in this case.

The sale of the property took place some time after the complaint was filed, and an attachment is made upon it in the replication. In this respect the replication is a departure, and states a cause of action which, if sustained by proof, would entitle the plaintiffs to relief of a nature altogether different from any that could be adjudged to them in the action as it was brought. If, by unfair or improper methods, the property was sacrificed, the plaintiffs, as creditors, would have just ground for complaint and, in a proper proceeding for the purpose, the defendants might be compelled to account for its actual value. But the object of this suit is the cancellation of the mortgage and assignment, and the
question of their validity cannot be affected by anything which took place after their execution. However so far as this record throws any light on the subject, the sale seems to have been conducted in accordance with the requirements of the mortgage. Nothing unfair in its management was made to appear, and there was no evidence from which we would be authorized to infer that the method pursued was not one calculated to bring the best price at the least expense. How a transfer, as security, of property of a value much greater than the amount of the debt, might affect the transaction as against other creditors, we do not find it necessary now to inquire, because we have before us no data to enable us to judge whether in this case the value of the property transferred was greater than the amount of the debt. The mortgaged goods brought $31,000, some thousands of dollars less than the principal; and whether the book accounts paid, or would have paid, the residue, or left a surplus after paying the residue, we have no means of forming an opinion.

The main question, however, in the case, and the one to which the argument on both sides is almost entirely directed, arises on the face of the pleadings. As shown by them, the corporation was insolvent, and the transfer included all of its assets, leaving nothing to be applied to the claims of the other creditors, except such surplus as might remain after the mortgage debt was satisfied; and the question is whether, in view of the financial condition of the corporation at the time, the preference given to the partnership and the bank can be sustained. It has been held by a number of courts that the assets of an insolvent corporation constitute a trust fund for the benefit of all of its creditors, and that, therefore, a corporation being insolvent, has no power to prefer particular creditors; and the same doctrine is vigorously and confidently
asserted by a distinguished legal authority. (44)

This doctrine, in so far as it has been judicially adopted, seems to be the outgrowth of a form of statement, used in some authorities, of a principle which has always been asserted, that corporate property must always be appropriated to the payment of corporate debts before there can be any distribution of its assets among its stockholders; and, as between stockholders and creditors, the corporate assets have been denominated a trust fund for the benefit of the creditors. (45) But there is a wide interval between the doctrine that the corporate debts must be paid before distribution to the stockholders and the doctrine that the insolvent corporation holds its property in trust for the equal benefit of all of its creditors, and there is no logical relation between the one and the other. The right of the insolvent individual to turn over his property to such of his creditors as he may desire to prefer is not questionable; and the principle reason assigned why an insolvent corporation may not do the same is that the individual by his act does not destroy himself, but may still acquire property and discharge his obligations, whereas, when the corporation dispossesses itself of all of its property, it becomes dissolved, and ceases to exist, so that unpaid creditors are for all future time remediless. But the force of the argument vanishes when we come to an examination of the assumption on which it rests. The insolvency of a corporation, and the loss of its property, do not, ipso facto, work its dissolution. Its legal powers remain intact. Its members, who supplied it with capital when it was created, may furnish a new capital, and it may resume business and discharge its debts. There is a possibility of an insolvent individual retrieving his condition,
and there is an equal possibility of an insolvent corporation retrieving its condition. Notwithstanding the confident language in which the extreme trust fund theory is asserted, the reasoning by which it is sought to be supported does not commend itself to us as sound.

But, aside from this, the weight of authority is that, in the absence of legislative prohibition, a corporation, even though it be insolvent, has the same power to make distinction between creditors, and give preference to some over others, that a natural person has. That an insolvent corporation must devote its property to the payment of its debts, and that it is not incorrect to call its assets a trust fund to be so applied, we readily concede; but that the question raised here is not touched by the concession, is not conceded. If the assets are all applied in the payment of some particular debts, to the exclusion of others, they are devoted to the purpose for which the corporation holds them, they are used, as far as they will go, in payment of its debts; but if any valid or substantial reason has been advanced for holding that a corporation, any more than a natural person, is bound to make a proportionate distribution of the fund among all its creditors, we have failed to find it, or it has failed to make an impression upon us. As far as the Colorado law is concerned, the precedent established in Breen v. Bank, (47) settles that point conclusively.

In this case it was held that the assets of an insolvent corporation do not constitute a trust fund for ratable distribution among all its creditors. It is true that the preference in that case was obtained by the levy of an attachment; and the plaintiff's counsel seeks to draw a distinction between a preference secured
by legal proceedings, and one voluntarily given by the debtor, con-
ceeding that in the former case the preference would be legal and
valid. We are not able to distinguish the logic of the distinc-
tion. If the assets are a trust fund, to ratable shares in which all
of the creditors are entitled, then it is not allowable to one cred-
itor, no matter what means he may employ for the purpose, to secure
more than his share, and thus enroach upon the rights of others;
but if the assets are not a trust fund for the benefit of all credi-
tors alike, then, in the absence of fraud, a preference which one
may acquire will be upheld, whether it is accorded to him voluntar-
ily, or he secures it by legal process. No such distinction is made
in the decisions on which the counsel relies. In Shoe Company v. Thom-
pson (supra) a creditor sought to secure a preference by an attach-
ment of the insolvent's property. The court said: "After the trust
attaches, neither the corporation nor the trustees can, by any act
of theirs, affect the rights of the creditors; and we think that it
necessarily follows that no creditor can, by any act of diligence
on his part, accomplish that which neither the corporation nor the
trustees could do by mutual agreement with him." There are expres-
sions to the same effect in the case of State v. Broekman, (supra)
and we are unable to find that any court, whose views on the main
question are in harmony with those of counsel, has hesitated, when
necessary, to follow this trust fund theory to its extreme logical
results. There being, neither on principle nor authority, any differ-
ence between the effect of a preference acquired one way and the
effect of a preference acquired in another, provided that the
transaction in each instance is bona fide, we must regard the de-
cision in Brown v. Bank as directly applicable to this case. The
question as to the extent to which the assets of an insolvent corporation might be held to be a trust fund for its creditors was considered by this court in the case of West v. Produce Company, (48) and the conclusion reached that they constituted a trust fund only as between creditors and stockholders.

A corporation organized for the purposes of trade has the inherent power, in carrying on its business, to use its credit and contract indebtedness. Although the objects for which it is formed must be expressed in the instrument of incorporation, and, though it may not engage in enterprises foreign to the purposes for which it was created, or otherwise transcend its legal powers, yet when, in the course of its business, it contracts an indebtedness, it assumes an obligation, its duties concerning which is governed, not by the provisions of its charter, but by laws which are applicable alike to corporations and natural persons. In the matter of the conduct of its business, its charter limits and defines its powers, and it must act within those powers; but the liability of both corporations and individuals, on account of indebtedness incurred by them, is regulated by general law. In inquiring how, in a given case, a corporation, insolvent or solvent, may satisfy the demands of its creditors, an investigation of its charter will afford no assistance. We must fall back upon laws to which all persons, natural or artificial, are subject. In respect to an indebtedness, a corporation may not do what an individual may not do; and, on the other hand, whatever an individual may do a corporation may do. There is no restriction upon the liberty of natural persons, so long as he keeps dominion over his property, to pay one creditor over another; and, as the liability of a corporation for its debts is measured by no rule dif-
fereht from that applicable to liabilities of natural persons, a preference in good faith by the corporation cannot be impeached.

The leading case in Illinois, and one that covers the doctrine of preferences to the extreme limit and opens the road to all kinds of fraud and iniquities, is the case of Rockford Wholesale Grocery Co. v. Standard Grocery and Meat Company (49). The facts briefly stated were about as follows: On February 21, 1896, the appellee corporation owed the appellant for goods sold $377.83, and at the time such indebtedness was incurred the appellee company was insolvent, and known to be so by the directors, although the fact was unknown to appellant, and was concealed from it by the management of the other company. Previous to the debt of the appellant, the appellee company owed the Manufacturers National Bank of Rockford $500, for which it had given its promissory note, upon which seven of the directors were guarantors of sureties for their company: That on the evening of February 21, 1896, the seven directors met, with one other, who later abandoned the meeting, authorized and caused to be executed by the corporation to the said bank a judgment note for the $500, knowing at the time the true insolvent condition of the company, and that a judgment and execution would consume all the property of the concern, leaving nothing for appellant or other creditors, and thereby gave to the bank a preference to the exclusion of the other creditors of the corporation: That the seven directors intended that the bank should take judgment upon such note and proceed to execution and sale, which the bank did on the following day, and the stock and fixtures of the appellee corporation, being
all of its property, were sold under execution, issued on such judgment of $245.33, and applied upon such judgment: That the property sold was worth more than the amount realized upon it: That appellant afterwards obtained judgment against appellee company for its claim, upon which execution issued and was, on July 87, 1896, returned with no property found and unsatisfied. And further, the bill concludes, the judgment note was given at the instigation of the seven directors to create a preference in their behalf, in their interest, to their advantage, to secure their liabilities, and to relieve themselves from the payment of the latter and becoming direct creditors of the corporation, and prays for personal decree against the seven directors participating in such action, requiring them to pay the judgment of appellant or some equitable proportion thereof.

The essential questions for decision are: May the directors of a known insolvent corporation give a preference to a creditor whose claim is secured by the personal guaranty of the directors? If this is true, do the directors giving such preference thereby become personally liable to the non-preferred creditors for payment of that which would be a pro rata share of the assets of the corporation if equally distributed among all of its creditors?

It may be conceded that the well established doctrine of the adjudicated cases is that the directors or other agents of an insolvent corporation cannot give themselves any preference or advantage in payment of claims due them by the corporation at the expense of other creditors. The general rule, however, is that in the absence of a statute to the contrary an insolvent corporation may, like natural persons in like condition, make preferences
to individual creditors or classes of creditors, over others (50).

In the case just cited the only grounds upon which it was contended that the creditors were not entitled to a preference, was that certain directors of the corporation had guaranteed the payment of their debts, which is the same question as is presented in the case under consideration. In Blair v. Steel Company the court said: "If it is a sufficient reason for depriving them of that right, it must be upon the theory that otherwise the preference would result in some benefit to the guarantors, directors of the company, and that too without any proof tending to establish that fact—that is to say, there is no affirmative proof in this record that these guarantors are solvent or can be made to respond to these creditors for any balance which may remain due them after the company assets are exhausted. For anything here appearing, if the contention that because the creditors had the names of the directors upon their note as guarantors deprives them of the right secured to other creditors to be preferred, be maintained; they must suffer loss merely because they must suffer loss merely because they had such guaranty. We do not understand that the rule which authorizes an insolvent corporation to give preference to one or more of its creditors or class of creditors in the distribution of its assets, to the exclusion of others, is limited by the mere fact that such preference may, in a certain contingency, result in benefit to directors of the company, and the authorities, so far as we have been able to ascertain, are to the contrary" (51).

Going back to the original case, the court holds, along the same line of reasoning as the above, that the directors had the right,
to virtually prefer themselves. The logic in both cases is open
to attack, and the precedent established promises to let down
the bars for all kinds of fraud and iniquity.

In Savage v. Miller et al. (39 Atl. Rep. 665--1898) the court
gets around the trust fund theory in a way that is novel if not
unique. There the dictum of the court is as follows: "Where the
note of a creditor has been lawfully preferred, the fact that
directors are endorsers thereon does not defeat his preference.
The result is to subrogate the general creditors to the rights of
the preferred against the endorsing directors to the extent of the
preference." The result would then be that the general creditors
may recover from the directors the excess given to the preferred
creditors over what they would have received had there been no
preference.

The case of O'Bear Jewelry Co. v. Volfer (52) is a leading one
on this subject, and the able argument and learned classification
of the different cases by the Honorable Justice McClellan warrants
the practical incorporation of his opinion in this paper.

The facts briefly stated are that the O'Bear Jewelry Company,
the defendant, below, is a corporation; the original plaintiffs
are Volfer et al., judgment creditors of the defendant; joined
with the defendant corporation are Johnston, its assignee under
a general assignment for the benefit of its creditors, the
Alabama National Bank, and four stockholders of the jewelry company.
The bill alleges that these stockholders have not paid in full for
stock, and seeks to compel them to do so. It also alleges that
the Alabama National Bank has received funds of the corporation
in fraud of its creditors, and seeks to compel the bank to account
for the same. The bill also prays that Johnston, the assignee, be required to file in court his account as assignee and to turn over to the court or to a receiver all the corporate property in his hands; and finally the bill prays that all the assets thus brought together be administered for the equal benefit of all the creditors of the corporation. The bill proceeds upon the theory "that the entire assets of said corporation constitute a trust fund for creditors." "This whole idea, that the property of insolvent corporations is held by them in trust for creditors—is a trust estate in their hands—and to be administered by chancery as such, originated in a dictum of Judge Story in Wood v. Dummer (53). It had no existence at common law, and none to this day in the law of England; but is distinctly a creation of some courts in this country, and known in the jurisdictions where it obtains as the "American Doctrine." This court has quite recently adopted it and held that the assets of an insolvent corporation is impressed with a trust in the hands of the company, in favor of its creditors first, and then in favor of its stockholders (54). The present writer dissented from the opinion and conclusion of the court in each of those cases. To his mind, there is nothing clearer in principle than the principle that the corporation, solvent or insolvent, bears identically the same relation to the creditors of such corporation as the property of an individual or co-partnership, solvent or insolvent, bears to the creditors of the individual or partnership; and is or is not to be impressed with a trust character upon the same circumstances and under the same
conditions in the first case as in the latter two."

The court then discussed several leading cases and pointed out that the "Trust Theory" is inconsistent with the decisions in Alabama and in some other states, which permit insolvent corporations to prefer one creditor to the exclusion of all others. He also said that the "Trust Theory" could not be sustained upon the ground that the relations between a corporation and its creditors constituted an express trust or a resulting trust. He then proceeded as follows:

"All constructive trusts are of three kinds, or arise from one or the other of three conditions of fact: first, trusts arising from actual fraud; second, trusts which arise from constructive fraud; third, trusts that arise from some equitable principle independent of the existence of fraud (55). As there is no fraud, actual or constructive, involved that a corporation is insolvent, has creditors which it is without assets to pay in full, and this fact is the basis for all the superstructure of this doctrine of trusts for its creditors, it cannot be conceived, and, I suppose, has never been contended, that such trust is referable to either the first or second heads of constructive trusts. And it is the conclusion of so high an authority as Mr. Pomeroy, that the third classification of constructive trusts stated above has no existence dissociated from actual or constructive fraud. It is his opinion "that all instances of constructive trusts properly so-called may be referred to what equity denominates fraud, either actual or constructive, as an essential element, and as their final source. Even in that single class where equity proceeds on the maxim that an intention to fulfill an obligation should be imputed, and
assumes that the purchaser intended to act in pursuance of his fiduciary duty, the notion of fraud is not involved simply because it is not absolutely necessary under the circumstances; the existence of the trust might in all cases of this class be referred to constructive fraud. This conception of fraud enters into the conception in all its possible degrees. Certain species of constructive trusts arise from actual fraud, many others spring from the violation of some positive fiduciary obligation; in all the remaining instances there is, latent perhaps, but none the less real, the necessary element of that unconscientious conduct which equity calls constructive fraud" (56). If this view be adopted, the relation between an insolvent corporation and its creditors is excluded from every possible category of constructive trusts for the reason, or by virtue of the fact, that that relation involves no fraud whatever, and as that relation is, as I have said, the sole ground for the doctrine of trusts in cases like this, the doctrine is unsound, unsupported in principle or reason, and should not be upheld by any court.

But if we adopt the view first stated above, that constructive trusts may arise by force of some equitable principle independent of the existence of fraud, actual or constructive, and which also seems to be the opinion of Mr. Perry (57), the same conclusion is equally inevitable. Eliminating the element of fraud from the consideration, there still remains as an essential predicate for the existence of a trust by construction of law, some unconscientious conduct on the part of the person to be held as trustee in invitium, or some unconscionable result through means or under circumstances which bring the transaction within some recognized
title of equity jurisprudence, as, for instance, where a tenant in common buys an outstanding term for his own benefit, he is trustee for his co-tenant, and where a conveyance has been made through ignorance, accident or mistake, the grantee will be the trustee in a constructive trust for the grantor. Thus, whenever one is placed in such relation to another that he becomes interested with or for him in property or business antagonistic to the person with whom he is associated, as, for illustration, if one partner, or other person occupying a fiduciary relation, renew a lease theretofore held by the partnership, or by the person renewing and another in confidential relation to him, in his own name and with his own funds, he will be a trustee for his associate by operation of law. And so, where by accident, ignorance or mistake, more land is embraced in a conveyance than was bargained and sold, a constructive arises in favor of the grantor for the excess(58).

But in all these cases, in all cases of constructive trusts where it is said by some authorities chancery proceeds without regard to fraud, relief is granted upon some acknowledged ground of equitable jurisdiction, and administered by holding the wrongdoer to account as trustee. There must be a confidential relation and unconscientious conduct on the part of the one party to, and in abuse of, that relation, or there must be some ignorance, accident, mistake or the like, against the unconscionable consequences of which equity will on general principles grant relief, else there can be no constructive trust.

That the relation of debtor and creditor is not of a confidential character there can, of course, be no doubt. 'Tis absurd to say
that the creation of that relation involves aught of accident, mistake or ignorance. That a debtor has property of his creditor which in equity and good conscience belongs to the creditor, because the debt created in its sale has never been paid, there is no warrant for saying. Equally unwarranted is the idea that in equity all property of the debtor who becomes insolvent belongs to the creditor and is held by the debtor in trust for him. And this idea of ownership in the cestui que trust underlies the whole doctrine of trusts of every description. In all trusts the legal title is in one, the equitable ownership in another. A mere debt against one who has property, whether solvent or insolvent, is not ownership, nor is a right to charge a fund, or a lien upon it, the beneficial ownership of it. Confessedly the property and assets of a solvent corporation do not constitute a trust fund for the benefit of its creditors. Can it be possible that the mere passing of a corporation from a state of solvency to a state of insolvency, amounts to a declaration of an express trust for creditors, or to a resulting trust upon the theory that title to the assets of the concern should have been made to the creditors? Or is it conceivable that this mutation from the one condition to the other does violence to a confidential relation which never existed, and hence is a constructive trust? Or, that this mere change of inherent conditions is the vestiture in the corporation through the ignorance or mistake of the creditors, or through fraud, of a greater title, or title to more property than was contemplated and intended, when before the change, confessedly the corporation had the absolute and indefeasible title free from all trusts to all its property and assets, and when the
change itself involves nothing of fraud, of abuse of fiduciary relations, of ignorance, or mistake or accident? The learned judges who uphold this "American Doctrine" may find something in these conditions of fact upon which to construct a trust, but I confess my utter inability to follow their argument or to see with their eyes. Nothing is clearer to my humble judgment than that the insolvency of a corporation—the existence of a corporation with property and debts, the property being insufficient to pay the debts—is not within any definition of any trust known to equity jurisprudence. The creditors of such corporation have the same rights against it as they have against an insolvent partnership or an insolvent individual debtor, and no other or more. They do not at law or in equity own the property of the one or the other, but the property of each is a fund for the payment of debts in the sense that neither can give it away, or dispose of it with intent to hinder, delay or defraud creditors. The property of the individual cannot be appropriated to his own use to the exclusion of his creditors under any cover whatever, the property of the partnership cannot be appropriated to the personal use of the partners, or in payment of the debts of the individuals composing the firm, to the exclusion of the partnership creditors under any pretense whatever. And so, the property of the corporation cannot be diverted to the use of the stockholders to the exclusion of creditors under any circumstances whatever. The powers and limitations upon the powers of an insolvent corporation to deal with its property are precisely the same in all essentials as the powers and limitations upon the powers of insolvent individuals and insolvent partnerships. The estate of
the debtor in each case is essentially the same—the corporation, no less than the individual and the partnership, is at law and in equity the owner of its property. The rights, remedies and estates of creditors of each are also the same. They do not own the property of their corporation debtor, or any interest in it, in equity or at law, any more than they own the property of their individual or partnership debtor. Their right against each is the same, to have their debts paid out of the property, but this right is not that of a cestui que trust, but, whether the property is corporate or individual or partnership, it is the even right of the creditors simply. Confessedly this right may be defeated as to any particular creditors by a sale of the property in payment of another creditor, or by its being taken on execution in favor of another, or even by its sale by the debtor—corporation, individual or partnership—to a third person, and this although such purchaser have notice of the insolvency of the debtor. All which, as I have seen, would be impossible if the property constituted a trust estate, with the corporation as trustee and the creditors as cestuis que trust, for in such case all who take with notice of the insolvency would take subject to the trust and themselves be held as trustees in invitum.

Not only are the rights of individual, partnership and corporation creditors the same against their insolvent debtors' estates, and each different in the same way from the rights of cestuis que trust, but the remedies of a corporation creditor, in the absence of a statute, are precisely those of a creditor of an individual or partnership. The remedy of each class of creditors may upon a given state of facts be in equity, and when this is so,
it is not because of any supposed trust, but upon some recognized ground of equity jurisprudence, as where the debtor has fraudulently transferred his or its property, and chancery is invoked to set aside the transfer and subject the property. And when chancery has thus assumed jurisdiction, it will administer the estate for the equal benefit of all creditors before it, and to that end the court becomes a sort of trustee sub modo, in the administration of the property, but not with any reference to the character of the estate, as being held in trust or otherwise, before or at the time jurisdiction attached.

Not all the publicists and courts of this country, nor the ablest of them, countenance this so called American Doctrine. Mr. Pomeroy expressly repudiates it. He says: "In applying this principle (of constructive trusts) care should be taken to distinguish between actual trusts and those relations which are trusts only by way of metaphor; between persons who are trustees, holding the legal title for a beneficial owner, and those who simply occupy a position which is analogous in some respects to that of a trustee. The use of these terms to designate relations and parties which have no essential element in common with actual trusts and trustees can only produce confusion and inaccuracy...... There are certain relations which are spoken of as trusts, and as constituting a species of constructive trust, but which are not, in any true and complete sense, trusts, and can only be called so by way of analogy or metaphor. Since they lack the element of fraud, they do not, in any view, properly belong to the division of constructive trusts...... The survivors of a partnership are called trustees for the estate of the deceased partner, with respect to his share
of the firm property. This expression is mostly metaphorical; there is certainly nothing in the relation resembling a constructive trust. Extending the analogy still further, courts regard partnership property, after an insolvency or dissolution of the firm, and in its proceedings for winding up its affairs, as a trust fund for the benefit of creditors, and the capital stock and other property of a private corporation, especially after their dissolution, is treated as a trust fund in favor of creditors. These statements may be sufficiently accurate as strong modes of expressing the doctrine that such property is a fund sacrely set apart for the payment of partnership and corporation creditors, before it can be appropriated to the use of individual partners or corporators, and that creditors have a lien upon it for their own security; but it is plain that no constructive trust can arise in favor of the creditors, unless the partners or directors, through fraud or a breach of fiduciary duty, wrongfully appropriate the property and acquire the legal title to it in their own names and thus place it beyond the use of creditors through ordinary legal means." And in a note to the above text the author says; "These cases are not constructive trusts, and are mentioned simply for the purpose of completeness and to distinguish between correct and mistaken conceptions"(59).

And the highest and ablest court in the land, the Supreme Court of the United States, has quite recently gone over this whole subject, considered exhaustively all its own decisions and dicta upon it, and in an able opinion by Mr. Justice Brewer repudiated the idea that the property of an insolvent corporation is a trust fund or estate held by the corporation or its officers for creditors.
as cestuis que trust. Judge Brewer quotes the language of Judge Bradley in Graham v. Railroad Co. (60) to the effect that when a corporation becomes insolvent, a court of equity at the instance of proper parties "will then make its funds trust funds, which in other circumstances are as much the absolute property of the corporation as any man's property is his", and says of that case, that "all that it decides is, that when a court of equity does take into its possession the assets of an insolvent corporation, it will administer them on the theory that in equity they belong to the creditors and stockholders rather than to the corporation itself." And he proceeds further to say: "It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder:" and he concludes his opinion upon this point as follows: "The same idea of equitable lien and trust exists to some extent in the case of partnership property. Whenever, a partnership becoming insolvent, a court of equity takes possession of its property, it recognizes the fact that in equity the partnership creditors have a right of payment out of these funds in preference to individual creditors, as well as superior to any claims of the partners themselves. And the partnership property is, therefore, sometimes said, not inaptly, to be held in trust for the partnership creditors, or, that they have an equitable lien on such property. Yet, all that is meant by such expressions is the existence of an equitable right which will be enforced whenever a court of equity, at the instance of a proper party and in a proper proceeding, has taken possession of the assets. It is never understood that there is a specific lien,
or a direct trust.

"A party may deal with a corporation with respect to its property in the same manner as an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called in to account for fraud or sometimes even for mere misjudgment in respect thereto; but as between itself and its creditors the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. That is certainly the general rule, and if there be any exceptions thereto they are not presented by any of the facts in this case. Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor, altogether, give to these simple contract creditors any lien upon the property of the corporation, nor charge any direct trust thereon" (61).

The Supreme Court of Minnesota, in an able opinion by Mitchell, J., (62) also repudiates this idea that the property of an insolvent corporation is a trust fund. Of it it has this to say: "This trust fund doctrine, commonly called the American Doctrine, has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a general idea, it is not sufficiently precise or accurate to
constitute a safe foundation upon which to erect a system of legal rules. The doctrine was invented by Justice Story in *Wood v. Dummer*, which called for no such invention, the facts in that case being that a bank divided up two-thirds of its capital stock among its stockholders without providing funds sufficient to pay its outstanding bill holders. Upon old and familiar principles, this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must be first appropriated to the payment of the debts of the company before there can be any distribution of it among stockholders—a proposition that is sound upon the plainest principles of common honesty (63). The expression used in *Wood v. Dummer* has, however, been taken up as a new discovery, which furnished a solution of every question on the subject. The phrase that "the capital of a corporation constitutes a trust fund for the benefit of creditors", is misleading. Corporate property is not held in trust in any proper sense of the term. A trust implies two estates or interests, one equitable and one legal; one person, as trustee, holding the legal title, while another, as the cestui que trust, has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee in the same sense and to the same extent as a natural person, but no further" (64).

Other authorities may be summoned to support this view of the case, but upon the strength of those already cited and the force
of the elementary principles of trust estates, it would seem that
the property of an insolvent corporation is not a trust fund or
estate accurately speaking, nor in any other sense than that when
the chancery court takes possession and control of such property
upon some general principle of equity jurisdiction, wholly inde­
dependent of any idea that the property constitutes a trust fund,
it will be administered for the equal benefit of creditors. It
follows that the bill cannot stand against the demurrers for
multifariousness unless that objection can be met upon some other
consideration than the trust character of the corporation property
and assets, which is alone and expressly, both in the averment of
the bill itself and in the argument of counsel, relied on to
support the decree overruling the demurrers.

That there is no clear and distinct rule of law in the case is
plain. If the definition of a corporation is carried out to the
fullest extent, that it is an artificial person, then, to keep
up the analogy, it would be necessary to concede them the right
to prefer creditors. There is such a wide divergency, however,
between the natural and artificial person, that the latter may
easily, by carrying out the doctrine of preferences, evade the
plainest rules of equity and moral right, and prefer integral
parts of the corporation, as for example, where the board of
directors may prefer some, or all, of their own members.

If this rule was carried out to the fullest extent, no one
would be safe in dealing with a corporation, as it would be
possible for the members of the board to bind their credit to the
corporation and, in the end, escape scathless and leave the
creditors of the corporation remediless. It is conceded that the
rule would work hardships in some cases, but if it became the practice of all courts to prohibit corporations from preferring creditors, it would lend security to the general creditors, and do nothing to enhance the general credit of corporations.

As to the proposition first treated; that the capital stock first subscribed is a trust fund, cannot be denied. It is the basis upon which the corporation is created and upon which its life depends. It seems to be the universal rule that such subscriptions shall be paid in full, if not in cash, with something of at least the same fair cash value.

To show the real diversity of opinion in the various courts there are fifteen or twenty late cases that may be summed up, and edited in the form of a digest. Through them it can be easily seen that there is no American Doctrine.

The expression that the property of a corporation constitutes a "trust fund" for its creditors only means that when the corporation is insolvent, and a court has possession of its assets, they must be appropriated to the payment of its debts before any distribution to the stockholders; but, as between a corporation itself and its creditors, the former does not hold its property in trust in favor of the creditors, in any other sense than does an individual debtor (65). Nor is the property of an insolvent corporation a trust estate in the hands of the corporation for its creditors, in the sense that insolvency alone will place it beyond the disposition of the corporation, or give equity jurisdiction to administer it as a trust estate, any more than in the case of an insolvent individual (66). The assets of an insolvent corporation are a trust fund for the benefit of creditors only...
after a court of equity, at the instance of a proper party, has taken possession of them (67). In the same sense, the property of a corporation is not a trust fund for its creditors in any such sense that its mere insolvency, while still a going concern, will prevent it from making a bona fide sale of all its property, which will be valid as against mere contract creditors (68).

On May 29, 1893, a certain corporation was in debt to the amount of $60,000, mainly for bank discounts, of which $8,500 was past due, $8,500 more was to become due prior to June 5th, and the balance prior to September 6th. Its officers estimated the value of the building, machinery, and stock of goods at about $75,000, but they were afterwards sold for $15,000 at public sale. There was due it for goods sold and consigned about $15,500, but one of the consignees had a large claim against it. Its president, a few days before, stated to a $3,000 creditor that it could not pay the money, but would give him a time draft. Held, that on May 29th the insolvency of the corporation was imminent within Laws 1892 (69) making a payment to a creditor by a corporation which is insolvent, or whose insolvency is imminent, when made with an intent to give a preference, void. In the same case the insolvent corporation paid a creditor $3,000, which was not due until June 5th. A few days before, on learning that such creditor would not extend the time of payment, the president stated that he could not pay the money, but would give the creditor a time draft. Its officers knew that it could not meet its obligations in the ordinary course of business, as they became due. On May 31st a suit in behalf of a friendly creditor was brought at the instigation of one or both of the managers, and two days afterwards
A suit was brought against the company by the secretary, on a note of $3,000 held by him. Held, that the payment of $3,000 to such creditor was with intent to give a preference to him and came within the laws cited in note 69, which provide that any payment made by a corporation, when its insolvency is imminent, with an intent to give a preference to any particular creditor, is invalid (70).

An insolvent railroad company, which has not constructed its road, may resell to a creditor in discharge of indebtedness, so as to prefer such creditor, rails bought to be used in the construction of the road, and for which it has no present use (71).

Though the liabilities of a corporation may greatly exceed its assets, it is not insolvent, in the sense that its assets become a trust, for pro rata distribution among its creditors, unless there is some positive act of insolvency, such as permanent cessation from business, the making of a general assignment, or the filing of a bill to administer its assets (72). Where a corporation becomes insolvent and ceases to do business, or by any act terminates its business without intention or ability to resume, its property and assets become a trust fund for all its creditors, between whom it can create no preference; nor can a creditor, by his own act, obtain a preference over others, who are in equity common owners of the property with him (73). Nor does the mere insolvency of a corporation convert its property into a trust fund, so as to prevent preferences (74).

An excess of liabilities over assets will not alone vitiate a security given by a corporation to a general creditor, so long as the corporation is a going concern; but when such security
covers practically all of its property, and the effect is to wind up its affairs in such a manner as to give a preference to the creditor secured, the giving of such security is an overt act of insolvency, and a court of chancery is authorized to set the conveyance aside, and take charge of the assets of the corporation for the equal benefit of all its creditors (75).

A new corporation was formed as a reorganization of an old one, under an agreement for the transfer to it of the property of the old corporation in consideration of the assumption of the latter's debts, except the claims of the non-assenting bondholders. A resolution was adopted authorizing the purchase, and a bill of sale was prepared, providing that the new corporation should assume all the debts of the old, except certain bonds. The reorganization committee reported that the had procured a bill of sale of all the property, which was to be delivered on "the assumption by the new company of all said debts and obligations." The chairman of the committee stated that the old company transferred all its property in consideration that the new company should assume all the debts and obligations of the old company, in addition to those specified in the reorganization agreement. Thereupon a resolution was adopted that the new company assume "all the debts, obligations and liabilities, of every kind and description, of (the old company), in addition to the bonds and other obligations mentioned in the agreement of reorganization." Held, that the obligation of the new company was to assume all the obligations of the old company, including its bonds (76).

The fact that the directors of a corporation were sureties on a note executed by the corporation, or that some of the directors
had given a joint note binding each individually as collateral security for the payment of a corporate debt, did not preclude the corporation from preferring the holder of its note or the owner of the debt, as against other creditors (77). And a corporation, though insolvent, may give a bona fide preference to a creditor; and a transfer of property to one of its stockholders, in consideration of his assumption of debts due certain creditors, is valid, as against other creditors, where a fair price is thus realized for the property (78); and an insolvent corporation may prefer creditors not its officers or agents, by deed of assignment or otherwise, in good faith, and before its assets have come into the possession of a court of equity (79).

Mere insolvency of a corporation does not deprive it of the power to dispose of corporate property, in good faith, by way of paying or securing corporate indebtedness, though the result may be to give one creditor a preference over others (80).
NOTES AND REFERENCES.

(1) 3 Mason, 308; Cummings Corporation Cases, 305.

(2) Vose v. Grant, 15 Mass. 505; Spear v. Grant, 16 do. 9.

(3) See (2).

(4) 1 Sch. & Bef. 243.

(5) 3 Maule & Selw. 562.


(7) 2 Swanston, 550.

(8) Ex parte Buffin, 6 Ves. 119; Ex parte Fell, 10 Ves. 347; Ex parte Williams, 11 Ves. 3; Ex parte Harris, 1 Madd. 583; Ex parte Kindell, 17 Ves. 514; Murray v. Murray, 5 Johns. Chan. 60; Ex parte Lodge v. Tindall, 1 Ves. Jr. 166; Taylor v. Fields, 4 Ves. 396; Young v. Kieghly, 15 Ves. 557.

(9) 15 Hôw. 304.

(10) 17 Ohio 187.


(12) 13 Wis. 57.

(13) Colman v. White, 14 Wis. 700; Nazro v. Merchants M. I. Co., id., 295; Cleveland v. Marine Bank, 17 id., 545.


(15) 9 Chan. Div. 322.


(19) 53 Ala. 371.

(20) Hightower v. Thornton, supra.


(32) Supra.
(34) 91 U.S. 45.
(35) 48 Minn. 174; 31 A.S.R 37.
(37) Rider v. Morrison, 54 Md. 429.
(38) Mann v. Pentz, 2 Sandf. Ch. 257; Payne v. Bullard, 23 Miss. 83, 55 A.D. 74.
(39) McAvity v. Senior Co., 82 Me. 504, 20 Atl. R. 82.
(40) Thompson Corp. sec. 2152.
(42) In re National Funds Insurance Co., 10 Ch. Div. 118.
(43) 46 C.L.J. 219, Court of App. of Colorado.
(47) 11 Colo. 97; 17 Pac. Rep. 280.
(49) 74 Ill App. 317.
(50) Blair v. Ill. Steel Co., 159 Ill 350.
(52) 106 Ala. 205.
(53) Supra.
(55) 10 Am. & Eng. Encyc. of Law, 60.
(57) I Perry on Trusts sec. 168.
(58) 10 Am. & Eng. Encyc. of Law 80.
(60) 102 U.S. 148.
(69) Chap. 688, Sec. 48.
(73) Orr & Lindsay Shoe Co. v. Thompson (TEx.), 35 S.W.Rep. 473.
(77) Milledgeville Banking Co. v. McIntyre Alliance Store (Ga), 25 S.E.Rep., 567.

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