INSOLVENCY-THE CO-DEBTOR AS A FACTOR IN DISTRIBUTION

Fred T. Hanson
Red Willow County Court, Nebraska

Follow this and additional works at: https://repository.law.umich.edu/mlr

Part of the Bankruptcy Law Commons

Recommended Citation
Available at: https://repository.law.umich.edu/mlr/vol35/iss7/4
INSOLVENCY—THE CO-DEBTOR AS A FACTOR IN DISTRIBUTION

Fred T. Hanson*

The problems in distribution peculiar to claims upon which another is liable with the insolvent have received little critical analysis in judicial decisions. This is largely because the chancery rule, governing the treatment of lienors, is widely accepted as the solution in every instance where one creditor has an exclusive resource from which he may obtain payment wholly or in part.

The foundation of the chancery rule is the theory that title to a ratable share of the insolvent’s assets vests in each creditor as an immediate consequence of transfer to a liquidating agent. The tableau of distribution thus fixed is thought to be unaffected by diminution of any one of the debts which originally measured the proportions. That the source of payment causing such reduction may be a co-debtor rather than a lien upon some part of the failed debtor’s assets is logically irrelevant, once the premise is admitted. A previous article presented an argument that such a notion of proportionate ownership is anachronistic. Can satisfactory rules for distribution in the co-debtor cases be developed without dependence upon this concept?

Such judicial discussions as are to be found usually relate to cases where the insolvent and the co-debtor stood in the relationship of principal and surety.

I

INSOLVENT SURETY

The division of a surety’s estate, unlike the case of a sole debtor, is not a finality so long as the principal remains solvent or his assets are

* Judge, Red Willow County Court, Nebraska. LL.B., Nebraska. Author of various articles in this and other legal periodicals.—Ed.

1 Hanson, “The Secured Creditor’s Share of an Insolvent Estate,” 34 Mich. L. Rev. 309 (1936). As the present article is in the nature of a sequel, familiarity with the contents of the previous one is assumed. However, the various security rules may here be briefly restated. Under the bankruptcy rule, the dividend basis upon which a secured creditor shares in the general estate is the face of the claim at the time of declaring any dividend, without regard to the remaining security. Under the Illinois rule, the balance due at the time of presenting the claim, with no deduction for security retained or for amounts subsequently realized from the same. Under the chancery rule, the full amount of the claim at the time of transfer in insolvency, with no reduction on account of security held or subsequent collections therefrom.

2 It must be assumed for the purpose of this discussion, that the surety’s obligation is
not exhausted. Eventually the creditor may collect from the principal the balance after dividends are credited and the liquidator may obtain reimbursement from the same source. However, such considerations are generally recognized as imponderable. In order that just division of presently available funds may be practicable, claimants' merely potential resources for payment, not controlled by the distributing authority, must be disregarded.

Payments actually made by a co-debtor who is primarily liable reduce the amount of the surety's obligation. When such payments are made while the surety remains in control of his assets, all authorities are agreed as to their effect. But in the case of payments made after a transfer for liquidation, it is quite generally held, as indicated in the introductory paragraphs, that the creditor has a vested proportionate ownership of the assets which is not affected thereby, and hence he continues to draw dividends upon the whole amount that was due him at the time of transfer.

To vindicate this result, it is sometimes posited that the creditor was equally entitled to collect the debt from either of the two debtors and should therefore have the benefit of whatever dividend upon the whole debt the estate of either will pay, subject of course, to the

not subject to a contingency which wholly precludes proof of the claim. Even in bankruptcy, where the terms of the Act (§ 63, 30 Stat. L. 544 at 562, 11 U. S. C., § 103) presented peculiar difficulties about contingent claims, it is now settled that an endorser's obligation is probable though the condition of presentment and notice of dishonor has not been satisfied. Maynard v. Elliott, 283 U. S. 273, 51 S. Ct. 390 (1931). The case of guaranty of collection is debatable. In re Merrill & Baker, (C. C. A. 2d, 1911) 186 F. 312, and In re Buzzini & Co., (D. C. N. Y. 1910) 183 F. 827, though conflicting, are both cited with approval in Maynard v. Elliott. If the contingency does not go merely to the surety's obligation but to the principal's as well (as in the case of a fidelity bond not yet breached by the principal), a more serious difficulty is presented.

It is said in Mercantile Nat. Bank v. Macfarlane, 71 Minn. 497 at 502, 74 N. W. 287 (1898):

"Immediately upon the payment of a dividend to the creditor, the receiver [for the surety] can proceed against the original obligors upon the paper, and as to them enforce collection of the amount paid; and, upon full payment of the obligation, the estate is subrogated to all of the creditors' rights as against prior parties."

For obvious reasons a liquidator, at least, cannot be required to pay the entire debt as a condition precedent to this remedy.

Accordingly, cases where co-debtors of the estate for which a dividend base is sought are likewise insolvent, and cases where they do not appear to be so, are here cited indiscriminately. See note 39 for comment upon a statute that fails to observe this principle.

See cases cited in note 6.
limitation that the creditor is entitled to but one satisfaction of the
debt. To reach the result by this reasoning, then, requires a premise
essentially identical with the title theory—that of an immutable tableau
established as of the date of transfer to the liquidator; as though a
single, immediate and complete division among all interested parties
were actually in prospect. Anything of the kind is, of course, impossible.
Negotiation and litigation over the collection of assets and the allow-
ance and classification of claims are among the factors that entail some
delay before any division is practicable and almost invariably require
the distribution itself to be made in several installments.

A liquidation does differ essentially from the dealings of a solvent
party. New commitments are avoided and the winding-up of those
existing is accelerated wherever possible. But both processes are sim-
ilar in that they are necessarily gradual. There is no satisfactory reason
for the radical difference between the theoretical conception of a
liquidation and the reality. A creditor's right of recovery against a
solvent surety is subject to successive reductions by the principal's
payments as well as by the surety's own. The amount on which the
creditor is entitled to a dividend at any given time ought, then, to be
measured by the same standard. This is the result that would be

---

6 In Beals v. Mayher, 174 Mass. 470 at 472, 54 N. E. 857 (1899), it is said:
"it is immaterial whether the subsequent payment is received from the maker
after proof made against the indorser or vice versa; for . . . to cut down the
dividends due on the proof made 'would be taking away from a man the double
security he had, and which he may make use of in law and equity, till he is
satisfied his whole debt.'"

In National Mt. Wollaston Bank v. Porter, 122 Mass. 308 (1877), the in-
donser first became insolvent, then the maker, becoming insolvent, paid 50% on a
composition. Determining the dividend basis for the indorser's estate, the court said
(p. 309):
"The plaintiff had received fifty per cent of its debt from the estate of the
maker, but this was no reason why the defendants [indorsers] should not pay
them the fifty per cent upon the whole debt as they had entered it upon their
schedule. The plaintiff was entitled to the benefit of its double security. Where
both maker and indorser are liable, the holder of a note may prove the amount
against each, and receive dividends to the full amount of his debt.'"

See also, Miller's Estate, 82 Pa. St. 113 (1876); In re Meyer, 78 Wis. 615,
48 N. W. 55, 11 L. R. A. 841 (1891), and Citizens' Bank v. Kendrick, 92 Tenn.
437, 21 S. W. 1070 (1893).

Sohier v. Loring, 6 Cash. (60 Mass.) 537 (1850), involved an estate secondarily
liable on bills of exchange held by several claimants, and having the same primary
debtor, who paid 1/5 under the terms of a composition. The court held that holders
who proved before payment under the composition ranked for the full amount, while
one who proved afterward ranked only for the 4/5 remaining due. The doctrine
thus established is analogous to the Illinois rule regarding lien security.
reached by applying here the principle of the Maryland rule concerning the dividends payable to holders of security. In whatever form theoretical arguments to the contrary may be stated, they are all traceable to the assumption that the transfer establishes a rest which governs all future computations.

The only practical reason advanced for the adoption of the rest is that administration of the Maryland rule is less convenient. It does require the liquidator to ascertain the balance due creditors who, by reason of a lien or the liability of a third person, might have been paid some amount since the transfer or the previous dividend. The factors that he must use are: (1) the balance actually due each creditor; (2) the total of such balances; and (3) the amount available for the dividend. To illustrate: An insolvent surety, $S$, owes $500,000. A creditor, $C$, has proved for $10,000$, and a first dividend of 40 per cent has been paid. The principal debtor, $P$, subsequently pays

---

7 The benefits that should accrue to the creditor having two debtors are discussed in the section entitled "Insolvent Co-principal," pp. 1117-1119, infra. A number of decisions have, in effect, applied the Maryland rule to these situations.

In Bank v. Alexander, 85 N. C. 352 at 354 (1881), involving distribution of the estate of an insolvent indorser, where the principal's assignment for creditors had previously yielded 66% of the debt, it was said:

"The measure of the provable debt is what remains of it unpaid, and as the discharged part could not be asserted against the principal, still less can it be against the surety upon his subsidiary liability. If the relations of the parties were reversed, and the surety had been compelled to pay the debt he would thus become himself a creditor, by virtue of an equitable assignment or right of action for money paid. But there is no analogy in the cases, and we can see no ground upon which the present claim can stand."

In In re Pulsifer, (D. C. Ill. 1880) 14 F. 247, the firm of Pulsifer & Co., indorsers on notes aggregating $40,000, were adjudged bankrupt in August, 1877, and on October 18 and November 21, 1877, by composition with the principal debtor, Woolner Bros., the creditor had received payments aggregating about $12,000. The court, distinguishing this case from that of an insolvent principal, says (p. 249):

"If the notes had been proved by the bank as holders against the estate of Woolners, the right to prove in full, notwithstanding payments received from the indorsers, would be manifest, because any excess collected would be held for the benefit of the surety; but an excess collected from these bankrupts could not be held in this case for the benefit of the makers. . . ."

See also Mercantile Nat. Bank v. Macfarlane, 71 Minn. 497, 74 N. W. 287 (1898), to the same effect.

8 Chemical Nat. Bank v. Armstrong, (C. C. A. 6th, 1893) 59 F. 372 at 378, one of the leading cases on lien security, contains this statement of the objection:

"The argument ab inconvenienti would weigh strongly against following this case [Third Nat. Bank v. Lanahan, 66 Md. 461, 7 A. 615 (1886)], even if its conclusion were not wrong in principle. The rule it lays down would require a readjustment of the basis of distribution at the time of declaring every dividend, and would involve endless labor and confusion. . . ."
$4,000 to C. There is approximately $50,000 available which the liquidator proposes to divide. None of the other creditors have security of any kind. C is to be paid on the basis of $2,000, the amount now actually due him, while each of the others must be paid upon the basis of the 60 per cent remaining unpaid. Accordingly, the gross indebtedness will be $300,000 (60 per cent of $500,000) less the $4,000 paid by P. Thus each factor is different, but all of the figures, except the payment by P, are available to the liquidator from his own record without any investigation.

By using the rest at the time of transfer, on the other hand, only the amount to be divided varies. The other factors for the second dividend would remain the same as for the first. This is true because the second dividend of 10 per cent will still leave $1,000 due C.

Assuming that another sum of $100,000 is accumulated for a final dividend, the amount available for C's claim under the rest method will be $2,000. But C should receive no more than the $1,000 remaining unpaid. When C is thus satisfied, the liquidator must subtract $10,000 from the total of claims, eliminate C from the list of creditors, and subtract the $1,000 paid to C from the amount available, in order to arrive at the basis for the other dividends. Thus all three factors require adjustment. If P had made a payment of more than 60 per cent before the first 40 per cent dividend was paid, such an adjustment would have been necessary immediately. In that event the tableau originally established would not have sufficed even for the first distribution.

The salient point is the necessity, under any method, of investigating all claims that are secured, whether by a third person's liability or otherwise, to ascertain if there have been any payments from these sources since the transfer or the preceding dividend, and the amount of the same, before the liquidator can make any computation. The more frequent readjustment of factors under the Maryland doctrine involves mere arithmetic after inquiry has developed the necessary

---

9 A circuitous method of reaching the same result is decreed in Fifth Nat. Bank of Grand Rapids v. Clinton Circuit Judge, 100 Mich. 67 at 74, 58 N. W. 648 (1894):

"It seems to us that much of the difficulty has arisen from an apportionment being based upon the amounts found due to the several creditors, whereas it should have been upon the faces of the respective claims as stated in the mortgage. If such apportionment resulted in extinguishing any claim or claims, the aggregate of such excesses would form a new fund, to be apportioned among the claims remaining unpaid, and this apportionment also should be based on the faces of the claims, and not on accounts remaining unpaid..."
facts and is accordingly an immaterial difference. Since both methods require the same investigative procedure for this class of claims (as well as those involving liens), the confutation of the argument *ab inconvenienti* is complete.

So far as the insolvent surety’s estate is concerned, therefore, no serious objection can be urged against distribution by the progressively ratable method set up by the Maryland rule. ¹⁰

II

INSOLVENT PRINCIPAL DEBTOR

The Maryland rule applied as suggested in the preceding section would likewise provide ratable distribution for the creditor when the insolvent is a principal debtor.¹¹ The creditor’s claim will not be discussed further except for such comments as are incidental to the treatment of the rights of sureties or co-principals.

The surety’s rights present a more intricate problem. If he has made no payment on the debt prior to the transfer for liquidation and makes none during the course of the proceedings he can, of course, receive no dividends. Yet he is clearly entitled to have the creditor’s security and right to dividends enforced for the purpose of exonerating him pro tanto. Even if he were not permitted to bring suit for exoneration against a solvent principal,¹² he should be allowed to make proof against an insolvent one on the creditor’s behalf and to enforce the securities if the creditor fails and refuses to do so.¹³ This involves

¹⁰ The chancery rule, on the other hand, is open to the same objections here as in the security cases: the distribution is not ratable at the time of division, and as White, J., shows by illustration in Merrill v. National Bank, 173 U. S. 131 at 150-151, 19 S. Ct. 360 (1899), it discriminates irrationally between a creditor who receives a payment from an outside source immediately before transfer and one who receives a similar payment immediately afterward.

¹¹ Board of Commrs. v. Gutelius, 99 Fla. 514, 126 So. 745 (1930), is decided on this theory. In applying the bankruptcy rule as to securities, it is held that payments made by sureties on bonds furnished by the insolvent must also be deducted. This gives the principal creditor ratable distribution, but it does not indicate how the right of the sureties to reimbursement is to be represented in the distribution, if at all. Thus one element of the balance due from the insolvent debtor upon the transaction is overlooked.

¹² The right to maintain such an action seems to be universally recognized. See notes in Ann. Cas. 1912C 369-372, and 117 Am. St. Rep. 35-41 (1908). The Michigan cases frequently cited contra are clearly distinguishable with respect to the type of relief which was sought. McElroy v. Hatheway, 44 Mich. 399, 6 N. W. 867 (1880); Nash v. Burchard, 87 Mich. 85, 49 N. W. 492 (1891).

¹³ See note 21.
no difficulty. If the surety pays the entire debt the answer is likewise simple, for he is subrogated to the creditor's remedies upon the debt itself and to the securities for its payment, and may therefore be treated exactly as though he were the principal creditor.

It is when the surety has made partial payments that complications arise. The analogies to be drawn from his several normal remedies do not provide a direct answer, but canvassing those remedies will contribute to an understanding of the problem.

The surety's right of subrogation, whether to the creditor's remedies upon the debt itself (as distinguished from the implied contract to reimburse) or to the securities held by the creditor, is normally subject to the condition that he first pay the balance of the debt. But this is because in the gradual process by which the relative rights of solvent parties are worked out through the independent operation of separate remedies accruing to the respective parties, superior and subordinate rights can be properly correlated only by the expedient of withholding the remedy from the subordinate until the superior is satisfied. The surety is not harmed by this, for he has other remedies by which he can obtain reimbursement. As soon as he has made any payment to the creditor he can maintain an action against his principal upon the contract for indemnity (which, if not expressed, is easily implied) or upon quasi-contract. That the maintenance of such an action involves the surety's competition with the creditor for the principal's assets seems to be regarded as immaterial so long as the principal has not gone into liquidation. Neither is it a matter of serious concern that these doctrines are so framed that surety and creditor have overlapping claims, the former for reimbursement of his part payment, the latter for the whole of the original claim. It is sufficient safeguard that the principal shall not be required to pay both claims.

When the principal's estate is being liquidated, a wholly different

14 Cases on this point are collected in the following notes: 9 A. L. R. 1596 (1920); 32 A. L. R. 568 (1924); 46 A. L. R. 857 (1927); 53 A. L. R. 304 (1928); and 91 A. L. R. 855 (1934).

15 See ARANT, Suretyship 322 et seq. (1931). Indemnity has sometimes been denied where \( S \) became bound to \( C \) without an express or implied request from \( P \), but this would seem to involve an inadequate grasp of the principles of quasi-contract.

16 At least this is the view taken in some cases of negotiable paper. Madison Square Bank v. Pierce, 137 N. Y. 444, 33 N. E. 557 (1893). BRANNON, Negotiable Instruments Law, 5th ed., 925 (1932). For the present purpose it is unnecessary to pursue the subject further because the significant point is that such holding in the case of the solvent principal is irrelevant to the question of liquidation with which we are concerned.
set of problems arise. Now the surety's various rights (contract for indemnity, quasi-contract, and subrogation to the creditor's cause of action upon the principal's personal obligation) are distinguishable only in theory. They do not even involve different forms of action, for each leads merely to proof of a money claim against the estate. On the other hand, competition between surety and creditor for the limited fund which is being administered becomes critical, and allowance of overlapping claims of creditor and surety becomes intolerable.

Three possible solutions are illustrated in the decisions:

(1) $S$ may prove independently for the amount he has paid, while $C$ proves for the whole debt without deduction of the amount paid by $S$.

(2) $S$ may prove independently for the amount he has paid, while $C$ proves only for the balance still due him.

(3) $S$ may be denied any independent claim, while $C$ proves the whole claim and holds for the benefit of $S$ any excess received over the amount due himself.

The first solution is not acceptable in any event, because it inflates the particular indebtedness by a species of double proof to the prejudice of other creditors. $P$ does owe two duties, one to $C$ and another to $S$. The latter includes an equitable duty to exonerate $S$ and another, both legal and equitable, to reimburse him. If there were several sureties the duties of $P$ would be still further multiplied. Yet $P$ owes in substance but one debt and could discharge all of these duties by one payment. The administration of the insolvent estate of $P$ must be controlled by the oneness of his debt rather than by the conceptual multiplicity of duties that have been evolved for other purposes. To allow proof of more than the one debt would defeat that ratable distribution which is the primary purpose of liquidation proceedings. Seldom have courts overlooked this elementary principle.17

When $S$ puts his claim on the theory of subrogation to $C$'s rights, the duplication of claims is too obvious to be missed. But when $S$ asserts his "independent" contractual or quasi-contractual right of indemnity, some courts have allowed substantive theory to override the realities of liquidation. For example, see United States Fidelity & Guaranty Co. v. Centropolis Bank, (C. C. A. 8th, 1927) 17 F. (2d) 913, 53 A. L. R. 295. It is to be hoped that this error has been buried by the decision of the Supreme Court in Jenkins v. National Surety Co., 277 U. S. 258, 48 S. Ct. 445 (1928). An attempt was made to narrow the doctrine of that case in Maryland Casualty Co. v. Fouts, (D. C. N. C. 1928) 27 F. (2d) 423, but this decision was reversed in Fouts v. Maryland Casualty Co., (C. C. A. 4th, 1929) 30 F. (2d) 357.

Further light upon the problem is derived from consideration of the case where a single creditor attempts to prove the insolvent's debt and also to prove upon a note or bond of the insolvent which has been executed by him as collateral security for the
In choosing between the remaining alternatives, regard must be had to the relationship between the parties to the transaction. In the simplest case the surety's liability upon the original indebtedness involved is coextensive with that of the principal and there is no special contract or circumstances varying their normal obligations. Here, as in every case, the estate of $P$ ought to pay dividends upon the aggregate of the sums due $C$ and $S$. But it was the normal duty of $S$, as a surety, to protect $C$ from loss due to the insolvency of $P$ and to absorb any such loss. Therefore the whole dividend ought to go to $C$ until he is satisfied, and the remainder to $S$. Thus the third alternative is plainly indicated. 17a

But where, because of the contract or relationship of the parties, the surety's obligation to the creditor is not coextensive with that of the principal, choice between the second and third alternatives involves difficult questions, and no categorical answer can be given. Distinctions must be drawn looking toward a reasonable construction of the contract between $S$ and $C$ and seeking to ascertain their relative equities in the light of that contract. The solution of this problem would in itself furnish material for an article, and cannot be undertaken here. How-

17a While Columbia Finance & Trust Co. v. Kentucky Union Ry., (C. C. A. 6th, 1894) 60 F. 794 is not as simple a case as the one supposed, it contains the following apt statement of this idea at p. 796:

"If the surety, upon making a partial payment ... became entitled to the position of an assignee of the property to the extent of such payment, it would operate to place such surety upon a footing of equality with the holders of the unpaid part of the debt, and, in case the property was insufficient to pay the remainder of the debt for which the guarantor was bound, the loss would logically fall proportionately upon the creditor and upon the surety. Such a result would be grossly inequitable."

This idea is also well stated in Brown v. Merchants & Farmers Nat. Bank, 79 N. C. 244 at 252 (1878):

"The surety whose estate pays, is at once subrogated to the rights of the creditor as to the sum paid, and thus the unpaid part would remain the property of the bank [the creditor], and the part paid would belong to the surety. But as both principal and surety owe the entire debt to the creditor, he would be entitled also to receive the part accruing to the surety as well as to himself out of the principal debtor's estate."
ever, the two main lines of thought and their consequences may be noted.

(1) Upon the one construction, the obligation of $S$ and the corresponding obligation of $P$ to which it is accessory are viewed as distinct from the balance of $P's$ obligation to $C$. The idea is that $S$ has not assumed liability for the balance of $P's$ obligation and therefore is not to be made indirectly liable for that balance nor prejudiced by the existence of that balance. Therefore, when $S$ has performed his own undertaking, he is substituted for $C$ with respect to the corresponding obligation of $P$ to $C$ (precisely as if there were no other obligation of $P$ to $C$) and may take the dividends which are payable on account of that obligation. If $S$ has not performed his undertaking, $C$ may prove the whole debt of $P$ but must credit $S$ with a proportionate part of the dividends.

(2) Upon the other construction, although $S$ has limited his liability to a stated sum and cannot be made to pay any greater amount, yet, subject to that stated limit, he is understood to have assumed liability for such part of the total debt of $P$ as $P$ himself does not satisfy. He is liable for the last penny and so for the whole. Therefore

---

18 If $S$ and $C$ both have normal contractual capacity, they can settle this question by explicit agreement, but there are few reported cases in which the agreement was definitive. See, one of these few, Midland Banking Co. v. Chambers, L. R. 4 Ch. App. 398 (1869). Absent explicit stipulations, we must look to the general nature of the agreement, with emphasis on what the parties did not contemplate.

The disjunctive construction (making the undertaking of $S$ and the corresponding obligation of $P$ independent) is presumptively indicated where the total debt of $P$ to $C$ is made up of obligations which have arisen in wholly separate transactions and rest upon wholly distinct considerations (e.g., several loans made at different times) and liability with respect to one of these obligations of $P$ has been assumed by $S$ by an agreement which contains no reference to the other obligations of $P$. See Citizens & Southern Bank v. Armstrong, 22 Ga. App. 138 (1918); Commercial Bank v. Cunningham, 24 Pick. (41 Mass.) 270 (1837).

This construction is also presumptively indicated where $S$ has executed a continuing guaranty limited in amount and $C$ has extended credit to $P$ beyond the limit of the guaranty. See Bardwell v. Lydall, 7 Bing. 489, 131 Eng. Rep. 189 (1831); Gray v. Seckham, L. R. 7 Ch. App. 680 (1872); Madison Nat. Bank v. Weber, 117 Oh. St. 290, 158 N. E. 543 (1927). In Dumont v. Fry, (C. C. N. Y. 1882) 14 F. 293, the opposite construction was based upon the rather slender circumstance that $S'$s agreement covered "any unpaid balance." But $P$ was a bank and $C$ its depositor, and the case must therefore be ranged with other cases of depository bonds which are discussed in note 19.

19 This is the natural construction where the whole debt of $P$ to $C$ arises out of a single transaction and rests upon the same consideration. See Ellis v. Emmanuel, L. R. 1 Exch. Div. 157 (1876); Commercial Casualty Ins. Co. v. Lawhead, (C. C. A. 4th, 1933) 62 F. (2d) 928; American Surety Co. v. Finletter, (C. C. A. 3d, 1921) 274 F. 152; Westinghouse Electric Co. v. Fidelity & Deposit Co., 251 Mass.
C is entitled to take dividends from the estate of P upon the whole claim and also to collect from S to the full amount of his undertaking, if both are necessary to his satisfaction. But C is entitled to no more than satisfaction, and S is therefore recognized as having a subordinate or junior interest in the claim of C against P and the dividends arising thereon. If C collects the dividends he can only hold S for the unpaid balance; and if this is less than the amount for which S assumed liability he has the benefit of the dividend to that extent. If S pays first,

418, 146 N. E. 711 (1925). Compare American Surety Co. v. Westinghouse Electric Co., 296 U. S. 133, 56 S. Ct. 9 (1936). This case involved, not competition of S and C for dividends from general assets of P but for the reserved percentage upon a construction contract, and the opinion emphasizes the policy of the statute in response to which the surety's undertaking was given. In Bergdoll v. Sopp, 227 Pa. 365, 76 A. 64 (1910), it was held that it should be left to the jury to decide whether a mortgage for $8000 given by S to C to secure a loan of $11,000 made by C to P "was security for but $8000 of the indebtedness" or "was given as a general indemnity against any loss on the entire $11,000 indebtedness." This put to the jury, in terms none too luminous, the ultimate question of construction without giving them any criterion for its solution. Query whether it did not call upon the jury to perform the function of the court?

Depository bonds are analogous to continuing guaranties, for they involve assumption of liability, limited in amount, for future obligations of P bank to its depositor C. Yet in these cases it is almost uniformly held that C may take all the dividends and hold S for any unpaid balance, though in other cases of continuing guaranty the opposite ruling prevails (see note 18). Nor is it easy to identify the distinguishing factors. (1) A distinction between penal bond and informal guaranty is too artificial to be satisfactory, and it will not reconcile all the cases. Compare Paley v. Field, 12 Ves. 435, 33 Eng. Rep. 164 (1806), and Dumont v. Fry, (C. C. N. Y. 1882) 14 F. 293. (2) A distinction between professional and amateur sureties will go far toward reconciling the decisions, but it will not explain Knaffl v. Knoxville Banking & Trust Co., 133 Tenn. 655, 182 S. W. 232 (1915). (3) Most of the depository cases involve public funds (the state or an instrumentality of the state was the creditor) and the peculiar protection which is so frequently accorded to the state is enough to explain these cases. This factor is the more significant where, as is usually the case, the bond is required by a mandatory statute: the argument is then made that the policy of the statute would be defeated if S shared dividends with C. Like reasoning invalidates stipulations for proportionate subrogation and other privileges which are not contemplated by the statute. Maryland Casualty Co. v. Sparks, (C. C. A. 6th, 1935) 76 F. (2d) 929; Board of Health v. Teutonia Bank & Trust Co., 137 La. 422, 68 So. 748 (1915); County of Oakland v. Central West Casualty Co., 266 Mich. 438, 254 N. W. 158 (1934); Sparks v. Detroit Fidelity & Surety Co., 268 Mich. 183, 255 N. W. 757 (1934); American Surety Co. v. Clark, 94 Mont. 1, 20 P. (2d) 831 (1933). But there was no statutory requirement of bond in Knaffl v. Knoxville Banking & Trust Co., 133 Tenn. 655, 182 S. W. 232 (1915), and it was private funds which were involved in Dumont v. Fry, (C. C. N. Y. 1882) 14 F. 293. Since there is no wholly satisfactory line of distinction, it is possible to argue that the depository bond cases and the continuing guaranty cases are all of one piece, and conflicting in their results. That seems to have been the view taken in Knaffl v. Knoxville Banking & Trust Co., supra.
though he cannot immediately displace C as creditor of P, he is entitled
to do so when the sum of S’s payment and dividends from P’s estate
have satisfied C: or, to the same purpose, C may be allowed to collect
the balance of the dividends but hold him as trustee for S of the excess
beyond the amount needed for his own satisfaction. In all of these
dispositions the entire debt of P to C is treated as a unity in which C
has a senior and S a subordinate interest.20

If there should be a number of secondary parties who had made
partial payments, the creditor would be trustee for all of them and
should pay them in proper order as far as the dividends will go, thus:

A, B, C, and D, co-sureties for an insolvent on a note for
$2,500, have paid $100, $200, $300 and $400 respectively, and
X, the payee and first indorser, has paid $500, and Y, second
indorser, has paid $600. The dividend would be on the basis of
$2,500 payable in the following order: holder $400; Y $600;
X $500; D $100; D and C ratably $200; D, C, and B ratably
$300; D, C, B, and A ratably $400.

If a similar diversity of payments made before the principal’s
insolvency were sufficient to satisfy the creditor, no logical reason
would remain for regarding him as an involuntary trustee. If some
representative for the varied interests involved was deemed desirable,
the party then having the senior interest would be the natural selection.

In the simple case involving one principal and one surety where
partial payments have been made by the surety after the transfer
for liquidation, the title theory fits perfectly with such a trusteeship.
Where such payments have been made before transfer, a propor­tion­ate share measured by the original debt is readily conceived to
vest in the creditor for the benefit of himself and the surety succes­sively. But even here the desired result may be compassed by a
realistic evaluation and correlation of the rights of the parties.

The Surety’s Remedy

Establishment of the creditor’s trusteeship affords the surety or
sureties ample protection. But the creditor may be ignorant of the
relationship between his debtors upon which he could base a claim of
that character. Even if cognizant of these facts, whether he owes the

20 See In re Pulsifer, (D. C. Ill. 1880) 14 F. 247; Swarts v. Fourth National
Bank, (C. C. A. 8th, 1902) 117 F. 1; Brown v. Merchants’ & Farmers’ Nat. Bank,
79 N. C. 244 (1878).
surety or sureties an affirmative duty in all cases to assert this purely constructive trusteeship is at least open to doubt.

In the event that he does not prove for the full amount, the surety or sureties would no doubt be permitted to supplement his proof by alleging the facts entitling them to relief, since it is generally held that if the principal creditor neglects or refuses to file a claim the surety may then do so.\textsuperscript{21}

Probably this is ample protection to the secondary parties. But direct action is desirable. The trust, created by judicial interpretation, with the surety as beneficiary, is largely passive. The creditor may be satisfied and therefore without interest in the claim. In any case his only function as trustee is to plead on behalf of the beneficiary and to pay over any funds that may be received for him.

Suppose that any surety is permitted to file a pleading alleging the amount originally owing to the creditor, his own relationship to the debt, the amount, if any, paid by him, and praying for appropriate relief, without first having made a demand upon the creditor for protection. Any separate claim filed by the creditor can be considered with those of secondary parties as a single claim. Whether the creditor eventually filed a claim or not, the whole matter could be determined without prejudice to him or anyone concerned. Hence the surety, whether he has paid anything or not, might well be granted an unconditional right to plead. Such a remedy is consonant with his independent cause of action for exoneration.\textsuperscript{22}

\textbf{III}

\textbf{Insolvent Co-Surety}

Cases involving an insolvent who is indebted as a co-surety give rise to a perplexing problem. It is presented in its simplest form where the insolvent's only co-surety has paid the entire debt. As the creditor is satisfied, the only question is one of contribution. If the nonpaying surety had remained solvent, he could not have been subjected to a

\textsuperscript{21}This is expressly provided for by section 57i of the Bankruptcy Act of 1898 (30 Stat. L. 544 at 560, 11 U. S. C., § 93i): "Whenever a creditor whose claim against a bankrupt estate is secured by the individual undertaking of any person fails to prove such claim, such person may do so in the creditor's name, and if he discharge such undertaking in whole or in part he shall be subrogated to that extent to the rights of the creditor."


\textsuperscript{22}See note 12.
judgment for more than his contributive share. This would be so even though the paying surety proceeded on the theory of subrogation to the creditor's rights, for subrogation is an equitable remedy which is always shaped to the requirements of justice. It is therefore to be supposed that when payment of the creditor by the one surety is followed by the insolvency of the co-surety, all courts would hold that the paying surety can only prove against the estate of the insolvent for the latter's contributive share.

Where the payment is made after the insolvency of the co-surety, judicial opinion divides along essentially the same lines as on other phases of this subject, and for substantially similar reasons. In one line of cases, the paying surety is allowed to prove only for the contributive share of the insolvent co-surety. In the other decisions, the paying surety is allowed to prove the whole debt which he has paid and to take dividends thereon until he receives the contributive share of the insolvent. The view that the paying surety can rate only what is then actually due him is in accord with the general doctrine that the distribution involved in each separate dividend must be strictly ratable. Decisions to the contrary are, of course, grounded chiefly upon the theory that the effect of transfer is to set aside for the par-

23 In German American Bank v. Fritz, 68 Wis. 390 (1887), the paying surety was subrogated to a judgment lien which had been acquired by the creditor upon the land of the co-surety, but he was not permitted to enforce the lien for more than the co-surety's contributive share.

24 For example, a surety who settles with the creditor for less than the amount of the debt cannot by subrogation recover more from the principal than he has paid. Succession of Dinkgrave, 31 La. Ann. 703 at 707 (1879); Brighthope Ry. v. Rogers, 76 Va. 443 at 448 (1881); In re Onstad's Estate, (Wis. 1937) 271 N. W. 652. In the Dinkgrave and Onstad cases, proof against the insolvent estate of P was allowed for the amount paid by S.

25 There is no clear case upon this point, though there are several in which the claimant paid the creditor after the insolvency of the co-surety. See notes 27 and 33 infra. The report of In re Thompson, (D. C. Pa. 1924) 300 F. 215, leaves the date of payment in doubt. If the payment preceeded insolvency, the decision is squarely contrary to the position taken herein, and it must be conceded that the policy argument advanced in the opinions quoted in note 32, infra, might lead a court to this extreme conclusion.

In Lidderdale v. Robinson, 12 Wheat. (25 U. S.) 594 (1827), a surety who paid before the insolvency of his co-surety was given the preferred status of the creditor, as a specialty creditor, in his proof against the estate of the co-surety.

26 It is startling to find proof allowed for a greater sum than the claimant is entitled to recover. If the result is based upon subrogation, it is a perversion of that equitable device, the chief virtue of which should be that it can be shaped to the requirements of justice.
ticular transaction a fixed proportion of the assets, which may be used until all interested parties have been satisfied. But these decisions rely upon other arguments as well.

If a dividend should be computed only on the contributive share, an insolvent estate able to pay 50 per cent would pay but 25 per cent upon the original claim, notwithstanding that the insolvent surety should have paid 50 per cent of it, and although a dividend on the full amount would have been sufficient for the purpose. This is said to be unjust. But the creditor no longer has any claim. That of the co-surety is for only half the amount originally owing to the creditor. From the view point of the liquidator and the other creditors represented by him, this is a full ratable dividend upon the co-surety's due. The implied agreement between the claimant and the insolvent, that, if the principal failed to pay, each would ultimately bear half of the debt, was not the only burden the claimant assumed. He also expressly promised the creditor payment of the entire debt.

The effect has been well stated: "in their relation to each other [as co-sureties] each was a principal for one half the amount recoverable for such default, and a surety for one half of it." As surety upon the insolvent's part of the debt, then, he also assumed the risk that, because of insolvency, his co-surety might discharge only such proportion of that half as his estate should prove sufficient to pay to creditors generally.

It is charged that such a rule encourages manipulation. By withholding payment the solvent surety can obtain the benefit of a larger

27 The following decisions are grounded directly upon the chancery rule; In re Thompson, (D. C. Pa. 1924) 300 F. 215; Hess's Estate, 69 Pa. 272 (1871); Pace v. Pace's Admr., 95 Va. 792, 30 S. E. 361 (1896). The last cited case quotes the leading statement of the title theory by Strong, J., in Miller's Appeal, 35 Pa. 481 (1860).

28 Miller's Estate, 82 Pa. 113 (1876) (quotation in note 38); In re Meyer, 78 Wis. 615, 48 N. W. 55 (1891).

29 In re Meyer, 78 Wis. 615 at 619, 48 N. W. 55 (1891), states this proposition as follows:

"That the holder of the note is the creditor of each severally for the whole amount due on the note, is uncontroverted, all courts holding that he may bring separate actions upon the note against the maker and indorsers for the whole amount due, and have several judgments for that amount . . . and that he may pursue his remedy upon such judgments until his debt is fully satisfied, and that if he can obtain satisfaction of such debt by enforcing the judgment against the indorsers alone he may do so without any hindrance." 30


dividend. And the liquidator, on behalf of the other creditors, may seek the advantages of a smaller dividend by delaying division until the solvent surety has been forced to pay.32

While the co-surety withholds payment, the entire dividend is accounted for by the creditor's right to collect the whole debt from the insolvent. Half of the dividend, and no more, finds concurrent support in the co-surety's potential right to contribution. Hence the advantage to the co-surety does not rest on his desert, and there can be no injustice in depriving him of it. On the other hand, if the liquidator delays division until the solvent surety has paid the creditor, the advantage to the estate flows from an actual reduction of that debt in a legitimate manner.

The opportunity to maneuver for position is manifestly inherent in the conception that several debtors may be liable in solido. If this effect cannot be avoided except by preserving the solvent surety's advantage even after the extinguishment of the creditor's right, which was its sole support, it is better to let possession of the advantage be determined by events, whether fortuitous or designed.33 As to pay-

32 For example, the Virginia court in Pace v. Pace's Adm'r., 95 Va. 791 at 799, 30 S. E. 361 (1898), says of the Massachusetts rule (stated in note 33):

"It encourages a policy of obstruction in the administration of estates, for if those interested in the insolvent estate can delay its settlement until the creditor demands his debt from the solvent surety, they reap the advantage by having a smaller debt to share with them in its distribution. On the other hand, temptation is held out for a corresponding effort on the part of the solvent surety to avoid paying, until the creditor has received such dividends as the insolvent estate will pay, because the amount for which he is liable is thereby reduced. It gives opportunity to the creditor, by collusion or otherwise to further the interest of one surety at the expense of the just and equal rights of the co-surety.

"Results like these, which depend, not on the rights of the parties fixed by law but upon the superior skill of one over the other in manoeuvring for position, or upon the will and caprice of the creditor, or upon mere accident, cannot be founded upon sound principles."

And in In re Thompson, (D. C. Pa. 1924) 300 F. 215 at 217-218 it is said:

"The application of this [chancery rule] makes the rights of the paying surety fixed and certain, instead of uncertain and depending on the caprice or election of the creditor to proceed first against the insolvent, or against the solvent surety, causing different results to the paying surety. Equity would seem to require that the rights of the parties should be definitely fixed by law, rather than made dependent on the uncertain procedure of the creditor."

33 New Bedford Institute for Savings v. Hathaway, 134 Mass. 69 at 75-76, 45 Am. Rep. 289 (1883), applies this principle where a co-surety of the insolvent satisfied the creditor after proof was made. The court said:

"neither in his own name nor in that of the creditor ought the surety paying the debt to enforce any claim against his co-surety, except for the amount actually
ments made immediately before the transfer, they are so determined in any event.

Thus the chancery rule discriminates illogically between a surety who pays his debt the day before the transfer of his co-surety's assets and one who pays a similar debt in a like amount the day after. Although in desert they are as nearly equal as possible, the amount realized by the first will be half as much as the second will receive. The rule produces similar effects in every field of its operation.

Weighing heavily against the principle of the Maryland rule is the conception, apparent in the decisions, of the manner in which it would apply where there are more than two co-sureties, one of whom had paid the entire debt. It is assumed that a surety would rate against the co-surety's assets only upon the insolvent's proportionate share of the debt, thus:

paid by him for his co-surety, and if, by reason of the insolvency of such surety there is a loss, it is one to which the relation in which they stand to each other compels him to submit. . . . The argument that the paying surety should be allowed to retain and avail himself of the proof of the whole debt made by the creditor, because he will thereby obtain only the amount which his co-surety ought to and would pay if he were not insolvent, is fallacious. He should be allowed . . . only to enforce the right which he has against the co-surety by reason of the payment which he has made on his account, and that was a payment of but one-half of the debt. As between himself and his co-obligor, it was his own duty to pay the other half. . . . To the creditor the co-surety had promised that he would pay the whole debt, but as between the sureties each was a debtor only to the amount of his proportion. To allow a co-surety to exaggerate his claim would do injustice to other creditors of the insolvent surety. . . . It is true that, as the creditors may think fit to proceed, different results to the surety may sometimes occur. If the creditor takes full payment from the solvent surety, it will be for the advantage of the estate of the insolvent surety. If on the other hand he proceeds in the first instance against the estate of the insolvent surety, it is for the advantage of the solvent surety. This result is produced by the different liability which the sureties owe to the creditor, and that which they are under each to the other, but it affords no reason for enlarging the latter."

The same result was reached in In re Bingham, (D. Vt. 1899) 94 F. 796, and In re Blanchard, (D. N. J. 1918) 253 F. 758, although in neither case was the question given the same close attention that it received in the New Bedford case.

The New Bedford case considered carefully every phase of the problem and the argument quoted above seems entirely sound, notwithstanding that the court also relied upon the unfortunate doctrine which Lord Eldon promulgated in Copis v. Middleton, Turn. & Rus. 224, 37 Eng. Rep. 1083 (1823), viz. that the paying surety though subrogated to collateral securities held by the creditor, is not subrogated to the personal obligation of the principal because that obligation is discharged by the payment. See comment on Lord Eldon's doctrine in 21 Mich. L. Rev. 795 (1923), and collection of American decisions in 68 L. R. A. 513 (1905).
A, B, C, and D are co-sureties for $1,000, all of which A has paid. B is insolvent. A would have dividends from B upon $250 only.\textsuperscript{34}

But by that method A's loss by reason of the principal's non-payment is composed of these items: $250 as his own share; the loss on B's $250 that may result from his insolvency; and the further risk of loss on the shares of C and D, should they prove insolvent.

At first glance that may seem no more than the component parts of the risk assumed by A. But B also took a risk of insolvency on the part of his co-sureties. As to C and D, that risk has not been eliminated, yet no part of it is represented in the dividend base against B. Since C and D are only potential sources of payment and not controlled by the distributing agency, they must be disregarded in arriving at a dividend base. If B can pay 100 per cent, A ought to receive $500 from him, and accordingly that is the amount on which B's estate ought to pay dividends. A still retains a contributive right in the amount of $500 against C and D, in which the liquidator will acquire an interest to the extent that the dividends he may pay to A exceed $250.

Cases involving payments in varying amounts by several co-sureties remain to be considered. The simple approach to this, and indeed all problems of distribution, is from the station of the insolvent. Assuming that no further payments will be made by any of the other parties, principals or sureties—a necessary assumption in establishing a dividend base—what is the insolvent under obligation to pay to the various parties to the transaction? First, as in other cases, his debt includes any balance remaining due to the creditor or to any other parties whose liability was secondary to that of the insolvent. Where none of the other sureties have paid more than their respective shares, this will be the whole dividend base. If, on the contrary, all co-sureties except the insolvent have paid more than their respective proportions, there should be added to the creditor's due such sum as would reimburse each co-surety in proper order for the excess over his contributive share.

\textsuperscript{34} The facts of In re Thompson, (D. C. Pa. 1924) 300 F. 215, are substantially like the illustration. The question is stated thus (p. 216):  
"Does the paying surety stand precisely in the shoes of the creditor whose claim he paid, thus entitling him to dividends as such creditor would have been, on the whole claim, as against the bankrupt surety, or only on the one-fourth part thereof? . . ."

The court then proceeded to state and apply the chancery rule (pp. 217-218).
A, B, C and D, co-sureties for $10,000, have paid as follows: A $1,000; B $2,600; C $2,800; and D $3,000. The estate of A will pay dividends upon $1,500, applied in this order: The creditor $600; D $200; and C and D ratably $400; and B, C, and D ratably $300.

Where some of the sureties have paid more and others less than their respective contributive shares, the dividend should be such sum as would apportion equally, between the insolvent and those of his co-sureties who had overpaid, the loss resulting from the underpayments, so far as that can be done by an authority distributing one estate:

1. Of the four co-sureties, A and B have paid nothing, C $3,400 and D $3,600. Dividends from A's estate are upon $3,333.33; $3,000 for the creditor, $200 for D and $133.33 pro rated to C and D.85

2. Supposing the above payments to be $3,000 by C and $4,000 by D; C's overpayment will not cover one-third of the loss from B's shortage. The dividend base for A's estate must accordingly take account of a loss of $2,000 to be shared with D, making the amount $3,500; $3,000 for the creditor and $500 for D.

IV

INSOLVENT CO-PRINCIPAL

Application of the Maryland rule to co-principals, either or both of whom are insolvent, would be simple if, for dividend purposes, the sum due from one could always be considered as reduced to the full extent of any payment by the other. From the creditor's viewpoint that seems true because, like other co-debtors, they are usually liable in solido. But aside from the creditor's rights, each should ultimately bear a fixed proportion of the debt. As between themselves, then, there are virtually two debts—one with the insolvent as principal and the co-debtor as surety, and the other with the parties reversed.86

Thus:

X and Y are co-principals indebted to C for $15,000, and the relations between these debtors is such that X should

85 This was the situation in Ex parte Stokes, DeGex 618 (1848). D was apparently allowed to prove the whole claim against the estate of A and to take dividends until he had received the contributive share of A. The conflicting rights of C were not discussed, and we should probably assume that they were eventually recognized in derogation of the claim of D.

eventually pay $10,000 and $5,000. For the $10,000 X is liable as principal and Y as surety, while for the $5,000 Y is principal and X is surety. Y becomes insolvent.

How should payments made by X be applied to this debt? The obvious answer is that they should be applied first to his primary and then to his secondary obligation. Until he had paid $10,000, accordingly, they would reduce the debt as in the case of an insolvent surety, but thereafter payments would operate to make the creditor trustee pro tanto for X as in the case of an insolvent principal.

Here, too, prompt payment is disadvantageous to the solvent debtor, inviting a Fabian contest between him and the liquidator. But this is the unavoidable effect of the difference between the respective debtors' liability to the creditor and their rights inter se. Victory for the solvent debtor brings him unmerited increment, whereas success for the liquidator means merely that the solvent debtor, in addition to his "principal" obligation, must bear that part of his "secondary" obligation which the insolvency of the "primary" party thrusts upon him.

The foregoing application of the Maryland rule can be made equally well where both parties are insolvent. In arriving at a dividend base for either estate at any time, dividends theretofore paid by the other should be treated as are partial payments by a solvent co-debtor.

If the objection, that this plan of dividend calculation deprives the creditor of benefits that should accrue from having two debtors, is cogent in the case of principal and surety, it is doubly so here. Up to a certain point payments by either debtor reduce the dividend base as to both estates. It is therefore pertinent to assay such a creditor's advantage, if any remains to him under this rule, over one who has a single debtor. The case where both debtors are insolvent should be the test, for if either of them is not, the creditor will eventually emerge unscathed.

37 Suppose the estate of Y is able to pay 33 1/3 per cent. If no payment has been made by X, C can prove the whole debt, $15,000, and will get a dividend of $5000, which will leave X to pay $10,000 which is merely his own share of the debt. If, on the other hand X has paid his $10,000 first, C can only prove for $5000 and will get a dividend of $1666.66, leaving X to pay $3333.33 more. The result will be the same if X has paid the whole $15,000: he will prove his claim for contribution of Y's share, $5000 and get a dividend of $1666.66. See In re Carmichael, (D. C. Iowa 1899) 96 F. 594; Ex parte Elton, 3 Ves. 238, 30 Eng. Rep. 988 (1796).

Even under the chancery rule the time of payment affects the ultimate burden of X if, as herein assumed the courts which adopt this rule would confine it to the case where payment follows the transfer in insolvency. See note 25.
1. The dividend base against each estate is at no time less, although it may be more, than the balance due the creditor himself, so that if either estate pays out he will have satisfaction. Consequently, his chance of avoiding loss is multiplied by the number of his debtors.

2. Whatever the order in which dividends are paid by the respective estates, such a creditor will realize in the aggregate a larger percentage of his claim than will any creditor of either estate alone, save in two events only: if one estate pays in full or if one estate pays nothing. In such cases he could fare no better under any other rule.

3. When one of the debtors has paid a dividend applicable to his own secondary liability, the creditor's dividend receivable from the other will be larger than is required by the actual balance due him. The contract between his debtors, to which alone this increment is attributable, may well be entirely unknown to him.

The mere assumption that a creditor having two debtors liable in solido is entitled to greater advantages than these manifestly cannot be accepted.

The method suggested for adjusting dividend bases to the contributive rights of several co-sureties may be applied by analogy. In either case ultimate liability may not be in equal amounts. If not, the contributions in respect of underpayments should perhaps be in mathematical proportion to the respective amounts for which the contributing parties were primarily liable.

CONCLUSION

Despite the variety of factual situations that may be produced by the number and relationship of the debtors, and the amount, source,
time and order of payments, the complete scheme of distribution here advocated can be succintly stated:

Each dividend shall be calculated upon the insolvent's actual indebtedness at the time when the dividend is declared. For this purpose it shall be assumed that other debtors liable upon the same obligation will make no further payments. The indebtedness involved in any transaction shall be considered to be the aggregate of the following items:

1. The balance due to the principal creditor.
2. Reimbursement for all parties subsequent in liability to the insolvent.
3. The amount due his co-ordinate debtors by way of contribution. This factor shall be the sum, if any, that is required to make the insolvent’s entire contribution toward payment of the debt as large, in proportion to his primary liability within the class, as that of any other member.

The total produced by the above factors in any transaction shall be regarded as constituting but one debt, which is payable to the interested parties in the order indicated by the above enumeration of items.

When various sums are due to several parties within the same class, successive dividends shall be apportioned to conform the ultimate burden to the rights of such parties between themselves, so far as the application of such dividends may accomplish that end.

It makes no difference, except perhaps in the matter of convenience, whether the distribution among the several co-debtors is made by the liquidator directly or through the medium of a trustee.

The diversity of doctrine concerning the treatment of lienors, more than anything else connected with liquidation, suggests a need for uniformity of rule. Modern legislation has placed the bankruptcy rule in the ascendant in its field. By it the lienor is required to deduct from his claim the value of his security upon the assets of the insolvent. Where the security involved is a third person’s liability this is malapropos. There the creditor would be prejudiced by diminution of his claim because of a resource entirely separate from the fund to which the equities of other creditors attach.39

39 In Southern Mich. Nat. Bank v. Byles, 67 Mich. 296 at 309, 34 N. W. 702 (1887), after stating that the rule for marshalling securities is inapplicable, the court says:

"The other creditors have no right, legal or equitable, to the money received by the bank from the indorsers."

Even where the creditor has a lien upon the third person’s property, he should
Yet there is an important similarity between this doctrine and the Maryland rule, which has furnished the analogy here. In both, the actual balance due is sought. Indeed, the bankruptcy rule pushes this search farther than it would be proper to do in co-debtor cases. In addition to requiring deduction of sums actually applied upon the debt, it extends the principle to any part of the distributable fund pledged for, although not yet applied to, the debt. The underlying philosophy is, therefore, identical. In a liquidation statute embodying not be treated as one who has a lien on the insolvent's property. Ivanhoe Bldg. & Loan Assn. v. Orr, 295 U. S. 243, 55 S. Ct. 685 (1935); In re United Cigar Stores Co., (C. C. A. 2d, 1934) 73 F. (2d) 296.

Legislation applying the bankruptcy rule literally to the distribution of the surety's assets is quoted marginally in In re United Security Trust Co., 321 Pa. 276 at 282, 184 A. 106, 109 (1936).

"but, if the insolvent is only secondarily liable, the value of the liability of the primary debtor shall be adjusted between the creditor and the assignee; or, if the valuation cannot be agreed on, the same shall be submitted to the appropriate tribunal, and a dividend shall only be awarded to the creditor on the difference between such value, so determined, and the amount of his claim. . . ."

Assuming that the principal's liability is found to be of some value hereunder, as the source of this credit is not the insolvent's estate, the dividend base is less than the debt either in law or equity. A payment of 100 per cent may still leave a balance, the collection of which is dependent upon the principal's ultimate degree of solvency. The creditor may justly complain that his share is not ratable and that he no longer has as many chances of satisfaction as he has debtors.

This identity of basic principle has not always been appreciated. The Massachusetts court, for example, was the first to adopt the bankruptcy rule upon principle and without legislative aid [Amory v. Francis, 16 Mass. 308 (1820)], but in later cases concerning insolvent sureties, while not professing any title theory, it proceeds on an identical principle (see "Insolvent Surety," supra, p. 1099 ff., differing only in that the rest is established at the time of proof rather than at transfer. [Massachusetts cases in note 6, particularly Sohier v. Loring, 6 Cush. (60 Mass.) 537 (1850).]

When the security is merely valued for the purpose of ascertaining the amount of the claim and is not presently applied to the debt, a procedure sanctioned in Amory v. Francis, the credit is and may remain, for an indefinite period after proof, a merely potential payment with an attendant risk to the creditor, as that decision recognizes. Yet a payment by a primary debtor actually applied in reduction of the debt during the same period would not reduce the dividend base. This is a manifest anomaly.

Of collateral interest is Blake v. Ames, 8 Allen (90 Mass.) 318 (1864), holding that where the doctrine of Sohier v. Loring produced a dividend from the indorser's estate larger than required to take up the principal's debt, the excess could not be applied to accrued interest. This is in accordance with the general rule suspending interest during liquidation proceedings. [See Hanson, "Effect of Insolvency Proceedings on Creditor's Right to Interest," 32 Mich. L. Rev. 1069 (1934).]

But if the basis of division accepted in Blake v. Ames is ratable, affording other creditors no grievance, neither can any disposition that may be made of the dividend computed thereon. Why, then, should not the interest, or so much of it as the dividend would cover, have been paid? This creditor's rights have become dormant, but are subject to be revived if dividends paid during its dormancy take up the principal
the bankruptcy rule, logical completeness and consistency would accordingly require a provision designed to bring the rules concerning co-debtors into harmony with it.

of all other claims of that class and leave a surplus for disposition. The decision is correct in withholding interest, but it serves to demonstrate the anomaly from another angle. This precise question concerning interest can arise whenever any dividend is calculated upon an amount exceeding the balance then due from the insolvent upon an entire transaction, whether liens or co-debtors are involved.

With reference to the method of reflecting the insolvent co-surety's contributive share, on the contrary, the Massachusetts court has adopted a view in accord with Amory v. Francis. New Bedford Institute for Savings v. Hathaway, 134 Mass. 69, 45 Am. Rep. 289 (1883), quoted in note 33, supra.