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CORPORATIONS-LIABILITY FOR UNPAID SUBSCRIPTIONS-POWER OF RECEIVER TO COLLECT UNPAID AMOUNT

CORPORATIONS—LIABILITY FOR UNPAID SUBSCRIPTIONS—POWER OF RECEIVER TO COLLECT UNPAID AMOUNT—The liability of a subscriber to corporate stock exists by virtue of the contractual obligation to the corporation to pay the subscription price or the unpaid installment thereon.[1] Because this liability is often declared by statute, it is essential, to avoid a confused analysis of the precise nature of the liability in question, to distinguish other types of stockholder's liability. Statutory super-added liability in excess of the par value of the stock, and liability for watered stock are excluded from consideration. An

[1] Ballantine, "Stockholders' Liability in Minnesota," 7 MINN. L. REV. 79 at 82 (1923).

analysis of the subscriber's liability will be materially aided by a classification with respect to plaintiffs entitled to compel the payment of the unpaid amount.

1. *Liability to the Corporation as a Going Concern*

The acceptance of the subscription by the corporation creates a contractual relation between the parties,[2] by virtue of which the subscriber may assert appropriate contractual defenses against the corporate enforcement of the agreed liability.[3] Similarly, the subscriber may demand, in the proper case, the performance of certain conditions precedent by the corporation before any liability upon the subscription accrues. What acts are necessary to occasion the default are of course dependent upon the terms of the subscription agreement. Where the agreed price is payable, either as a whole or in part, immediately or upon a specified date, the subscriber's duty to pay depends merely upon the passage of time.[4] However, where no definite time of payment is stipulated, but the promise to pay is conditioned upon a call by the corporation, either by virtue of statute, articles of incorporation, by-laws, or the subscription contract, a valid call, together with notice and a reasonable opportunity for the satisfaction of the accrued liability, is necessary to create the subscriber's obligation to pay the amount of the call.[5]

[2] Pre-incorporation subscriptions, upon acceptance by the corporation, are binding. Crawford v. Coleman Hotel Corp., (Tex. Civ. App. 1928) 3 S. W. (2d) 1109; Perry Hotel Co. v. Courtney, 102 Fla. 1041, 136 So. 691 (1931); Nebraska Chicory Co. v. Lednicky, 79 Neb. 587, 113 N. W. 245 (1907). The question of their validity will usually be raised by an attempted revocation by the subscriber before acceptance by the corporation. See 44 HARV. L. REV. 126 (1930); 27 MICH. L. REV. 467 (1929); 39 YALE L. J. 427 (1930).

[3] Thus fraudulent representations in the inducement of the subscription will justify rescission. Tyler v. Savage, 143 U. S. 79, 12 Sup. Ct. 340 (1892), or a defense at law, Vulcan Fire Ins. Co. v. Jorgensen, 33 Cal. App. 763, 166 Pac. 835 (1917). Cases admitting other defenses: Woods Motor Vehicle Co. v. Brady, 181 N. Y. 145, 73 N. E. 674 (1905), material variance between intended and actual corporate purpose; Tomberlin v. Waycross Commercial Hotel Co., 41 Ga. App. 77, 152 S. E. 300 (1930), failure to comply with the Georgia Securities Act; Salem Mill Dam Corp. v. Ropes, 23 Mass. 23 (1827), failure to secure subscription to the full amount of the agreed capital, with which compare Tyler v. Receivers of Cambridge Furniture Co., 160 Md. 333, 152 Atl. 896 (1931); Commonwealth Binding & Casualty Ins. Co. v. Hill, (Tex. Civ. App. 1916) 184 S. W. 247; 6 A. L. R. 1116 (1920). See generally, 1 COOK, CORPORATIONS, 8th ed., c's. 9 and 10 (1923). *Cf.* Posey v. Citizens' State Bank, 93 Okla. 266, 220 Pac. 628 (1923).

[4] Myrtle Point Mill & Lumber Co. v. Clarke, 104 Ore. 128, 203 Pac. 588 (1922); Packard De Luxe Lines, Inc. v. Hudson, 248 Ill. App. 579 (1928); Northwood Union Shoe Co. v. Pray, 67 N. H. 435, 32 Atl. 770 (1893).

[5] Vegetable Oil Corp. v. Twohy, 86 Cal. App. 409, 260 Pac. 813 (1927); Louisiana Oil Exploration Co. v. Raskob, 32 Del. 564, 127 Atl. 713 (1925); BALLANTINE, PRIVATE CORPORATIONS 634 (1927).

Upon the subscriber's default, various courses of action are open to the corporation. Recovery at law upon the promise to pay, either express or implied from the fact of subscription and acceptance by the corporation,[6] may be justified as the collection of a debt owing the corporation.[7] Successful maintenance of this action, in the absence of contractual or statutory restriction, does not require the issuance or tender of the stock certificate prior to suit since the completion of the contract constitutes the subscriber a stockholder.[8] On the other hand, statutes have admitted the propriety, upon default, of the exercise of the self-help remedy of forfeiture of the stock, either with or without sale.[9] Until the forfeiture is completely effected, however, the corporation is not precluded from resort to the law action to enforce the personal liability, since it originates in the contract independently of statute.[10]

While judicial opinion is divided upon the question of the necessity of notice of the call prior to suit, the requirement that it be given is in accordance with business expediency and sound legal principles. Hughes v. Antietam Mfg. Co., 34 Md. 316 (1870); Wear v. Jacksonville R. R., 24 Ill. 594 (1860). See generally 1 COOK, CORPORATIONS, 8th ed., sec's. 117, 118 (1923). If the call fails to set the time of payment, the amount should be payable on demand. Western Improvement Co. v. Des Moines Nat. Bank, 103 Iowa 455, 72 N. W. 657 (1897); *cf.* 33 HARV. L. REV. 862 (1920).

[6] Puget Sound & C. R. R. v. Ouellette, 7 Wash. 265, 34 Pac. 929 (1893); Planters' & Merchants' Independent Packet Co. v. Webb, 144 Ala. 666, 39 So. 562 (1905).

[7] Hauger v. International Trading Co., (Ky. 1919) 214 S. W. 438; Commerce Trust Co. v. Hettinger, 181 Mo. App. 338, 168 S. W. 911 (1914); Geary St., P. & O. R. R. v. Bradbury Estate Co., 179 Cal. 46, 175 Pac. 457 (1918); Positype Corp. v. Mahin, (C. C. A. 2d, 1929) 32 F. (2d) 202; Brookline Canning & Packing Co. v. Evans, 163 Mo. App. 564, 146 S. W. 828 (1912), with which compare Wicks Stone Co. v. Dickason, 276 Ill. 590, 115 N. E. 176 (1917); Philadelphia Motor Speedway Ass'n v. Sale, 69 Pa. Super. 583 (1918).

[8] In re Hannevig, (C. C. A. 2d, 1925) 10 F. (2d) 941; 4 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 1830 (1931). However, in some jurisdictions, before the corporation may require full payment, it must be ready and willing to deliver the subscribed stock. Leigh v. Chattanooga, R. & C. R. R., 104 Ga. 13, 30 S. E. 381 (1898); Walter A. Wood Harvester Co. v. Jefferson, 71 Minn. 367, 74 N. W. 149 (1898).

[9] The Delaware Statute is typical. Rev. Code of Del. (1915), sec. 1936: "When any stockholder fails to pay any instalment or call upon his stock which may have been properly assessed thereon by the directors, at the time when such payment is due, the directors may collect the amount of such instalments or call any balance thereof remaining unpaid, from the said stockholder by an action at law, or they shall sell at public sale such part of the shares of such delinquent stockholder as will pay all assessments then due from him with interest and all incidental expenses, and shall transfer the shares so sold to the purchaser, who shall be entitled to a certificate therefor." Then follow provisions for notice of the sale, and a forfeiture of the stock to the corporation in case any deficiency upon the sale is not recovered from the delinquent.

The forfeiture remedy may be created by virtue of the subscription agreement also. Boston, B. & G. R. R. v. Wellington, 113 Mass. 79 (1873).

[10] Muskogee Industrial Development Co. v. Ayres, 55 Okla. 152, 154 Pac. 1170

But upon the perfection of the forfeiture, the defaulting subscriber is, in the absence of anything to the contrary in the statute or the articles of incorporation, relieved of all further liability to the corporation, except that of any deficiency which may arise by virtue of a sacrifice sale of the stock.[11]

Nor is the right to enforce the liability for the unpaid amount of the subscription limited to the corporation. By virtue of the principles which sustain a stockholder derivative suit, a stockholder who has paid in full has been allowed to enforce the liability of a delinquent subscriber upon a showing of an abuse of discretion by the board of directors by their refusal to require the subscription payment for the benefit of the corporation. Facts necessary to constitute an abuse of discretion are of course peculiar to each case, but at least the inactivity of the board in the face of pressing creditor's claims will furnish strong evidence on which to ground judicial entertainment of this sort of corporate recovery.[12]

The principles developed are strictly limited to the legal incidents attendant upon the subscription contract as distinguished from a contract for the purchase and sale of corporate stock.[13] Because the purchaser under the latter type of contract is denied the status of a stockholder until performance, the issuance or tender of stock becomes a necessary prerequisite to a successful recovery by the corporation from the defaulting purchaser.[14] More important, this postponed stock-

(1916); Nashua Sav. Bank v. Anglo-American Land, Mortgage & Agency Co., 189 U. S. 221, 23 Sup. Ct. 517 (1903); Big Creek Ditch Co. v. Hulick, 130 Ore. 408, 280 Pac. 495 (1929), noted in 39 YALE L. J. 580 (1930); Imperial Land & Stock Co. v. Oster, 34 Cal. App. 776, 168 Pac. 1159 (1917); cases collected in 83 A. L. R. 892 (1933). Of course, the statutory remedy may be rendered exclusive by the subscription agreement, Denman v. Country Club Realty Co., 143 Ark. 502, 220 S. W. 824 (1920), or by the terms of the statute itself, Parkhurst v. Mexican Southeastern R. R., 102 Ill. App. 507 (1902).

[11] 4 FLETCHER, ENCYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 1867 (1931); Small v. Herkimer Mfg. & Hydraulic Co., 2 N. Y. 330 (1849); Stokes v. Lebanon & Sparta Turnpike Co., 6 Humph. (25 Tenn.) 241 (1845). If the sale of the stock creates a surplus rather than a deficiency, the defaulting subscriber is entitled to a refund. Atlantic Dynamite Co. v. Andrews, 97 Mich. 466, 56 N. W. 858 (1893).

[12] Bergman v. Evans, 92 Wash. 158, 158 Pac. 961 (1916). *Cf.* Hartnett v. St. Louis Mining & Milling Co., 51 Mont. 395, 153 Pac. 437 (1915); 15 MINN L. REV. 453 (1931).

[13] Generally a subscription to corporate stock may be made before or after incorporation. Reagan v. Midland Packing Co., (D. C. N. D. Iowa 1924) 298 Fed. 500; Stern v. Mayer, 166 Minn. 346, 207 N. W. 737 (1926), although some cases limit subscriptions to those made before the creation of the corporation. Bole v. Fulton, 233 Pa. 609, 82 Atl. 947 (1912); Guaranty Mtg. Co. v. Wilcox, 62 Utah 184, 218 Pac. 133, 30 A. L. R. 1324 (1923). *Cf.* Chubb v. Upton, 95 U. S. 665 (1877).

[14] Daniels v. Craiglow, 131 Kan. 500, 292 Pac. 771 (1930); Security Title & Trust Co. v. Stewart, 154 App. Div. 434, 139 N. Y. S. 74 (1913).

holder's status imposes a measure of liability upon the non-performing purchaser different from that to which the subscriber is subject: namely, to the corporation, the difference between the contract and market price rather than the unpaid amount of the subscription,[15] and to the corporate creditor, the agreed purchase price rather than the amount necessary to satisfy corporate debts.[16] While the character of the particular agreement is determined, of course, by the terms of the contract and the intention of the parties, the use of certain words, such as "purchase" and "stock shall be issued upon the completion of the payment thereof" are indicative of the acquisition of stockholder's rights only at a future date.[17]

2. *Liability to Creditors of the Corporation*

Decisions uniformly admit to the corporate creditor the right to compel the payment of the unpaid subscription to the extent necessary to satisfy the debt.[18] Popular justification for this creditor's relief has been grounded in the theory that the stated capital of a corporation exists as a trust fund for the benefit of creditors whose equities require satisfaction of their claims by the payment of the subscribed capital.[19] This analysis is both unnecessary and inaccurate, for it fails to recognize the derivative right of a corporate creditor to compel the application of a contractual asset to his debt.[20]

The procedural shape of the individual creditor's suit to enforce the subscriber's liability will depend primarily upon statutory provi-

[15] See Bole v. Fulton, 233 Pa. 609, 82 Atl. 947 (1912).

[16] Sargent v. Waterbury, 83 Ore. 159, 161 Pac. 443 (1916), rehearing denied, 163 Pac. 416 (1917). *Cf.* 13 MINN. L. REV. 257 (1929).

[17] Boroseptic Chemical Co. v. Nelson, 53 S. D. 546, 221 N. W. 264 (1928), noted in 13 MINN. L. REV. 257 (1929). *Cf.* Wood Harvester Co. v. Jefferson, 57 Minn. 456, 59 N. W. 532 (1894); Dickinson County Hospital Co. v. Kessinger, 128 Kan. 576, 279 Pac. 7 (1929), noted in 39 YALE L. J. 427 (1930); First Caldwell Oil Co. v. Hunt, 101 N. J. L. 240, 127 Atl. 209 (1925).

[18] 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 6051 (1932); Ogilvie v. Knox Ins. Co., 63 U. S. 380, 15 L. ed. 490 (1859); Hatch v. Dana, 101 U. S. 205, 25 L. ed. 885 (1879); Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388 (1900); Blood v. La Serena Land & Water Co., 150 Cal. 764, 89 Pac. 1090 (1907); Williams' Ex'r v. Chamberlain, 123 Ky. 150, 94 S. W. 29 (1906).

[19] 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 6052 (1932); BALLANTINE, PRIVATE CORPORATIONS 641 *et seq.* (1927); Atwood v. McKenzie-Waterhouse Co., 120 Wash. 214, 206 Pac. 978 (1922); Marion Trust Co. v. Blish, 170 Ind. 686, 85 N. E. 344, 18 L. R. A. (N. S.) 347 (1908).

[20] Vermont Marble Co. v. Declez Granite Co., 135 Cal. 579, 67 Pac. 1057, 56 L. R. A. 728, 87 Am. St. Rep. 143 (1902); 11 CAL. L. REV. 362 (1923). See particularly the opinion of Myers, J., in Spencer v. Anderson, 193 Cal. 1, 222 Pac. 355, 35 A. L. R. 822 (1924). *Cf.* Jeffery v. Selwyn, 220 N. Y. 77, 115 N. E. 275 (1917).

sions.[21] Thus legislation has granted recovery at law, although in the absence of express statutory authorization, the creditor's indirect relation to the subscription contract precluded this action for the unpaid amount.[22] By statute and judicial decision, the creditor's bill in equity after an unsatisfied judgment against the corporation has been established as the normal device for the collection of this asset.[23] Since this suit requires the joining of all willing creditors,[24] the suing creditor is denied a complete preference over the delinquent subscriptions. However, there is no such joinder of parties requirement to prevent the random selection as defendants of those delinquent subscribers from whom satisfaction of the debt can be expected. As a result of this unrestricted method of suit by the creditor, the defending subscriber may be compelled to pay the whole unpaid amount of his subscription, if necessary to satisfy the creditors, without regard to the proportionate liability of the other delinquents.[25] This possible inequality constitutes a serious defect in the prosecution of the individual remedy, and is not entirely eliminated by allowing the paying subscriber to exact contribution from those who have escaped the creditor's demand, for the expense of the contribution suit may be a large item.

In view of the limitations upon the prosecution of the individual remedies, and in view of the fact that the creditor's resort to the unpaid subscription is only necessary when the corporate assets are insufficient to meet the debts, a collective process is the more desirable procedure by which to enforce the creditor's right to satisfaction from the unpaid subscriptions. Hence, legislation generally has admitted the propriety of a receivership as the means of securing this relief to the complaining creditors. The nature of the receivership proceeding will depend upon its purpose, whether for liquidation, dissolution, or the mere collection and conservation of assets, and its origin, whether statutory or equit-

[21] Again the Delaware statute is typical. 22 Del. Laws, c. 394, sec. 49 (p. 777), provides that when the stockholders of a corporation are liable to pay the debts of the company, any person to whom they are liable may have an action at law against any one or more of the stockholders, or may have his remedy by bill in chancery. Sec. 51 declares that no suit may be brought against a stockholder for any debt of the corporation until judgment be obtained against such corporation and returned unsatisfied. *Cf.* Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39, 7. A. L. R. 972 (1920).

[22] Patterson v. Lynde, 106 U. S. 519, 1 Sup. Ct. 432 (1882); Montesano v. Carr, 80 Wash. 384, 141 Pac. 894 (1914). *Cf.* First Nat. Bank v. Peavey, (C. C. N. D. Iowa 1895) 69 Fed. 455. See generally 7 A. L. R. 100 (1920).

[23] See notes 18 and 21 supra. *Cf.* John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917).

[24] Geo. W. Signor Tie Co. v. Monett & S. W. Const. Co., (D. C. E. D. Mo. 1912) 198 Fed. 412.

[25] Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388 (1900); Harrell v. Blount, 112 Ga. 711, 38 S. E. 56 (1901); cases cited in note 18, supra. *Cf.* Dempster v. Ashton, 125 Neb. 535, 250 N. W. 917 (1933), involving a receiver's suit.

able. Under the common form of remedial statute, however, any creditor may, upon the insolvency of the corporation, procure the judicial appointment of a receiver, who thereupon becomes invested with the rights and title of the corporation for the purpose of collecting the assets for the benefit of all assenting creditors. By virtue of this acquisition of corporate rights, the receiver is entitled to compel the payment of the unpaid subscriptions to the extent, at least, necessary to satisfy creditors.[26] The exact procedure by which this is accomplished depends entirely upon the statutory provisions and the equity practice of the particular jurisdiction, but in general two divergent methods may be noted. Certain courts, proceeding upon the theory that the receiver is entitled to collect the unpaid subscription price as any other corporate obligation in order to marshall the corporate assets, uphold the power of the receiver to proceed at law or equity against all of the delinquent subscribers without a judicial ascertainment of existing debts.[27] Upon

[26] Rev. Code 1915, sec. 3883:

"Whenever a corporation shall be insolvent, the Chancellor, on the application and for the benefit of any creditor or stockholder thereof, may, at any time, in his discretion, appoint one or more persons to be receivers of and for such corporation, to take charge of the estate, effects, business and affairs thereof, and to collect the outstanding debts, claims, and property due and belonging to the company, with power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits. . . ."

Sec. 3884: "The receiver or receivers appointed by the Chancellor, of and for any corporation created by or existing under the laws of the State of Delaware, and the successor or successors of any such receiver or receivers, shall upon his or their appointment and qualifications, and the survivors or survivor of such receivers shall upon the death, resignation or discharge of any co-receiver or co-receivers, be vested by operation of law, without any act or deed, with the title of such corporation to all its books, papers and documents, interests in patents, patent rights, copyrights and trademarks, rights of action arising upon contracts or from the unlawful taking or detention of or injury to property of such corporation, and other property, real, personal or mixed of whatsoever nature, kind, class or description, and wheresoever situate, except real estate situate outside the State."

See John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917), as modified by Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920). *Cf.* the Kansas statute as construed by the court in Guilbert v. Kessinger, 173 Mo. App. 680, 160 S. W. 17 (1913). See Hodde v. Hahn, 283 Mo. 320, 222 S. W. 799 (1920); Republic Iron & Steel Co. v. Carlton, (C. C. Md. 1911) 189 Fed. 126; 1 COOK, CORPORATIONS, 8th ed., sec. 208 (1923); 1 TARDY, SMITH ON RECEIVERS, 2d ed., sec's. 350, 351 (pp. 884, 890) (1920); 2 CLARK, RECEIVERS, 2d ed., sec. 830 (1929).

After the inception of the collective process, the creditor is precluded prosecution of any individual remedy to reach this asset. Geigy Co. v. Wilfling, 50 R. I. 506, 149 Atl. 609 (1930); Herf & Frerichs Chemical Co. v. Brewster, (Tex. Civ. App. 1909) 117 S. W. 880; Big. Creek Stone Co. v. Seward, 144 Ind. 205, 42 N. E. 464 (1895). *Cf.* Van Arsdale v. Richards, 247 Ky. 77, 56 S. W. (2d) 728 (1933).

[27] Graves v. Denny, 15 Ga. App. 718, 84 S. E. 187 (1915); Cosmopolitan Life Ins. Co. v. Sheets, 20 Ga. App. 622, 93 S. E. 507 (1917); Guilbert v. Kessinger,

the collection of all the available assets, an equitable adjustment of the rights of the creditors and stockholders is made by the appointing court. On the other hand, because of legislative or judicial emphasis upon the proportionate liability of the subscriber to the creditors upon corporate insolvency, decisions deny the receiver's recovery of this type of asset until a judicial determination of the extent of the subscriber's proportionate liability.[27a] Mechanically this is fixed by means of an assessment proceeding instituted in the appointing court by the receiver, in which proceeding the amount of the debts and available assets of the corporation are computed, and a pro rata assessment is levied upon the delinquent subscribers to the extent necessary to satisfy the outstanding claims. To enforce the levy the receiver may sue the assessed subscriber at law [28] or equity [29] without regard to the territorial limits of the appointing jurisdiction, and in this action, personal defenses only may be litigated as the assessment, even though *ex parte* in nature, is conclusive as to the amount and necessity thereof.[30]

For the purpose of determining the nature and extent of the title

173 Mo. App. 680, 160 S. W. 17 (1913); Hundley v. Hewitt, 195 Ala. 647, 71 So. 419 (1916); Preston v. Jeffers, 179 Ky. 384, 200 S. W. 654 (1918); Bracken v. Stuart, 32 Ohio App. 399, 168 N. E. 149 (1929), with which compare Clarke v. Thomas, 34 Ohio St. 46 (1877); Hartman v. Ins. Co. of Valley of Va., 32 Gratt. (73 Va.) 242 (1879). *Cf.* Pope v. Merchants' Trust Co., 118 Tenn. 506, 103 S. W. 792 (1907); Jackson, F. & M. Ins. Co. v. Walle, 105 La. 89, 29 So. 503 (1900), with which compare Bank of Kaplan v. Richards, 165 La. 659, 115 So. 815 (1928); Meholin v. Carlson, 17 Idaho 742, 107 Pac. 755 (1910).

[27a] Rosoff v. Gilbert Transp. Co., (D. C. Conn. 1913) 204 Fed. 349; Cumberland Lumber Co. v. Clinton Hill Lumber Mfg. Co., 57 N. J. Eq. 627, 42 Atl. 585 (1899); John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917), as modified by Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920). *Cf.* Cook v. Carpenter, 212 Pa. 165, 61 Atl. 799 (1905); In re Bass, (D. C. N. D. Ga. 1914) 215 Fed. 275; Fletcher v. Bank of Lonoke, 71 Ark. 1, 69 S. W. 580 (1902).

Where the debts will exceed the total amount of the unpaid subscriptions, a judicial determination of the proportionate liability is unnecessary. Beach v. Beach Hotel Corp., 117 Conn. 445, 168 Atl. 785 (1933); Goldstein v. Leitch, 142 Md. 184, 120 Atl. 369 (1923).

[28] Jeffery v. Selwyn, 220 N. Y. 77, 115 N. E. 275 (1917); Hosner v. Conservative Casualty Co., 99 Wash. 161, 168 Pac. 1122 (1917); Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920); Thomas v. Kalbfus, 97 Ohio St. 232, 119 N. E. 412 (1918); Chubb v. Upton, 95 U. S. 665 (1877).

[29] Allen v. Rhodes, (C. C. A. 8th, 1916) 230 Fed. 321; Hodde v. Hahn, 283 Mo. 320, 222 S. W. 799 (1920). *Contra,* Fidelity Trust & Safe Deposit Co. v. Archer, (C. C. A. 3d, 1909) 179 Fed. 32.

[30] Rosoff v. Gilbert Transp. Co., (D. C. Conn. 1915) 221 Fed. 972; Shaw v. Lincoln Hotel Corp., 18 Del. Ch. 87, 156 Atl. 199 (1931). *Contra,* Grady v. Graham, 64 Wash. 436, 116 Pac. 1098 (1911), although in Cox v. Dickie, 48 Wash. 264, 93 Pac. 523 (1908), it was held that notice by publication was sufficient to make the assessment conclusive upon the subscriber. But see Connor v. Robinson, 137 Wash. 672, 243 Pac. 849 (1926). See generally, 10 CAL. L. REV. 341 (1922).

to be asserted in the litigation, the receiver is generally regarded as representing the corporation.[31] However, decisions have excluded in the receiver's suit certain defenses available to the subscriber against the corporation. Failure to occasion the subscriber's default by virtue of a call prior to insolvency is not fatal to the receiver's recovery of the unpaid subscription, for the appointing court may take the proper steps to fix the liability.[32] Even affirmative acts raising an estoppel against the corporation afford no defense to the receiver's suit. Thus, fraudulent representations in the inducement of the subscription will not ground a rescission after insolvency unless the right of rescission is asserted by the defrauded subscriber with reasonable diligence, and no debts have been incurred by the corporation subsequent to the fraud.[33] Similarly, watered or bonus stock agreements, existing by virtue of the corporate acceptance of insufficient cash or property as full payment

[31] HIGH, RECEIVERS, 4th ed., sec. 315 (1910).

[32] Glenn v. Marbury, 145 U. S. 499, 12 Sup. Ct. 914 (1892); Glenn v. Williams, 60 Md. 93 (1882); Thomas v. Kalbfus, 97 Ohio St. 232, 119 N. E. 412 (1918); Shaw v. Lincoln Hotel Corp., 18 Del. Ch. 87, 156 Atl. 199 (1931); 1 COOK, CORPORATIONS, 8th ed., sec. 207 (1923). Nor is the individual remedy precluded the creditor by the failure of the corporation to make a call. Daggett v. Southwest Packing Co., 155 Cal. 762, 103 Pac. 204 (1909).

The question of the operation of the statute of limitations upon the subscriber's liability to creditors has been the source of judicial conflict in the situation where the subscriptions are payable upon call and the corporation has failed to make a call. Perhaps the weight of authority favors the view that the subscriber's liability is not fixed until a call is made, either by the board of directors or the equity court. Other decisions regard the insolvency of the corporation as the date of the arising of the creditor's cause of action. See 35 A. L. R. 832 (1925) for an exhaustive collection of cases.

[33] Lex v. Selway Steel Corp., 203 Iowa 792, 206 N. W. 586 (1925); with which compare State ex rel. Havner v. Associated Packing Co., Williams v. Thompson, 216 Iowa 1053, 249 N. W. 761 (1933), noted in 47 HARV. L. REV. 528 (1934). The latter case represents the culmination of protracted litigation involving the involuntary dissolution of the Associated Packing Company for its fraudulent incorporation. See 90 A. L. R. 1350 (1934). After apparently following the rule of the Lex case as to rescission after insolvency in Wade v. Swartzendomber, 206 Iowa 637, 220 N. W. 67 (1928), and Hynes v. Arbozast, 210 Iowa 754, 227 N. W. 627 (1929), the Iowa court in the final case, State ex rel. Havner v. Associated Packing Co., supra, reversed its previous position in allowing rescission by limiting the decision of the Lex case to the situation where there had been valid incorporation. See also Steele v. Singletary, 120 S. C. 132, 110 S. E. 833 (1922); Meholin v. Carlson, 17 Idaho 742, 107 Pac. 755 (1910); Preston v. Jeffers, 179 Ky. 384, 200 S. W. 654 (1918); Chubb v. Upton, 95 U. S. 665 (1877); 46 A. L. R. 484 (1927); 17 VA. L. REV. 580 (1931); 29 MICH. L. REV. 369 (1931); 13 MINN. L. REV. 729 (1929). *Cf.* Marion Trust Co. v. Blish, 170 Ind. 686, 84 N. E. 814, 18 L. R. A. (N. S.) 347 (1908). However, a subscriber who has rescinded prior to insolvency becomes a creditor. Goldstein v. Leitch, 142 Md. 184, 120 Atl. 369 (1923).

of the par value of the issued stock, do not preclude the receiver's recovery of the difference between the par value and the amount paid.[84]

3. *Liability to Other Stockholders*

The possibility of disproportionate subscriber's liability for corporate debts exists in almost every situation where the corporate assets are insufficient to satisfy creditors and resort to the unpaid subscriptions is necessary. As stated above, the employment of the individual creditors' remedy to enforce the subscription delinquency affords the greatest opportunity for inequality in this respect. Nor does the use of the collective remedy insure complete proportionate liability, even though the assessment proceeding may be imposed as a procedural check. While this device guarantees equality among those who are able to pay, it cannot exact the levy from those insolvent delinquents whose financial irresponsibility may necessitate a further assessment upon

[84] Since this type of stock involves no unpaid subscription, liability to the receiver for the benefit of creditors must be placed on grounds other than the passing of a corporate asset. Decisions, in compelling the payment of the amount necessary to satisfy creditors, have adopted three kinds of approach, the most popular of which has been the judicial pronouncement that the capital stock of a corporation constitutes a trust fund for the benefit of creditors in view of their presumed reliance upon the amount of capital represented. Sawyer v. Hoag, 84 U. S. 610, 21 L. ed. 731 (1873); 56 A. L. R. 396 (1928); 81 A. L. R. 198 (1932); 39 HARV. L. REV. 757 (1926); Bonbright, "Shareholders' Defenses Against Liability to Creditors on Watered Stock," 25 COL. L. REV. 408 (1925). Other decisions, proceeding upon a similar basis of presumed reliance, uphold the receiver's recovery upon the theory that the false representations of the existence of a certain amount of subscribed capital constitutes a fraud on creditors. Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N. W. 1117 (1892); Ballantine, "Stockholders' Liability in Minnesota," 7 MINN. L. REV. 79 at 82 (1923). Still other courts admit this creditors' relief by judicially effectuating the legislative policy expressed by those statutes which require the payment of shares of stock to the extent of the par value or the amount necessary to satisfy creditors. Easton Nat. Bank v. American Brick & Tile Co., 70 N. J. Eq. 732, 64 Atl. 917 (1906); John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917); Butterworth v. Ross, 238 Mass. 279, 130 N. E. 678 (1921). *Cf.* Reel v. Brammer, (Ind. 1913) 101 N. E. 1043, and James v. Bosworth, 223 Ky. 1, 2 S. W. (2d) 1075 (1927), in both of which recovery by the receiver was denied upon the theory that the receiver took only the rights of the corporation.

For cases involving the question of the effect of the creditor's knowledge of the unpaid stock upon the stockholder's liability, see 7 A. L. R. 972 (1920); 69 A. L. R. 881 (1930).

Further illustrations of the judicial protection of the unsatisfied creditor are found in the exclusion, as to the receiver, of such defenses as failure of the corporation to secure the agreed capital, Allen v. Rhodes, (C. C. A. 8th, 1916) 230 Fed. 321, cancellation of the subscription after insolvency, Forcum v. Symmes, 106 Fla. 510, 143 So. 630 (1932) [with which compare Schwemer v. Fry, 212 Wis. 88, 249 N. W. 62 (1933)], and forfeiture of shares after insolvency for non-payment of calls, 19 A. L. R. 1096 (1922). *Cf.* Cox v. Dickie, 48 Wash. 264, 93 Pac. 523 (1908).

those paying the original call. In addition, no recognition is accorded the subscriber who has made complete or partial payment prior to the levy, for the assessment is computed upon the basis of present outstanding debts and unpaid subscriptions without regard to the fact that the amount already collected from the paying subscriber has been appropriated for the satisfaction of corporate debts also. Individual liability for corporate debts, in view of the voluntary engagement of the contributories in a common enterprise, should be measured in proportion to the agreed capital contribution of each subscriber. When circumstances impose a liability which is greater than that borne proportionately by every other delinquent subscriber, equitable principles demand that a substantive right to equalize the loss be admitted in the subscriber. Hence upon the equitable ground that equality of burden creates equality of right, statutes and judicial decisions uphold the right of the subscriber who has, either voluntarily or involuntarily, paid more than his proportionate share of the corporate debts to enforce contribution from those who have escaped performance of their obligation.[35]

The enforcement of the right of contribution raises the question of the procedural shape of the suit. One device, preventative rather than remedial, is the use of a crossbill in the creditor's suit to subject the other delinquents to the common liability.[36] And of course an independent suit is always available as a means of equalizing the losses.[37] The propriety of a third method has been questioned by recent Delaware litigation. Upon the insolvency of the Griffith Mortgage Corporation, a creditor's petition resulted in the appointment of a receiver who immediately sued a subscriber at law upon a subscription note.[38] The court, in dismissing the action, held that the Delaware statute giving prominence to proportionate liability to creditors upon insolv-

[35] Lex v. Selway Steel Corp., 203 Iowa 792, 206 N. W. 586 (1925), noted in 39 HARV. L. REV. 772 (1926); Allen v. Fairbanks, (C. C. Vt. 1891) 45 Fed. 445; Siegel v. Fish, 129 Ill. App. 319 (1906); Bank of Des Arc v. Moody, 110 Ark. 39, 161 S. W. 134 (1913); Putnam v. Misochi, 189 Mass. 421, 75 N. E. 956 (1905); BALLANTINE, PRIVATE CORPORATIONS 643 (1927). *Cf.* John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917), as modified by Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920); Gardiner v. Bank of Napa, 160 Cal. 577, 117 Pac. 667 (1911); Merrill v. Prescott, 67 Kan. 767, 74 Pac. 259 (1903). *Cf.* Allfather v. Schlicher, 86 N. J. Eq. 1, 97 Atl. 491 (1916), in which case contribution was denied the paying subscriber by reason of the fraudulent organization of the corporation.

[36] See Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388 (1900); Siegel v. Fish, 129 Ill. App. 319 (1906).

[37] Bennison v. McConnell, 56 Neb. 46, 76 N. W. 412 (1898); Allen v. Fairbanks, (C. C. Vt. 1891) 45 Fed. 445; Merrill v. Prescott, 67 Kan. 767, 74 Pac. 259 (1903).

[38] Philips v. Slocomb, (Del. 1933) 167 Atl. 698.

ency [39] and the established Delaware procedure requiring judicial ascertainment of the amount necessary to satisfy creditors [40] precluded recovery of the whole unpaid amount in the absence of a showing that the unpaid subscription was for the purpose of the payment of debts or equalization of stockholders' losses. Thereupon the receiver applied to the equity court for an assessment to the extent of the whole unpaid amount upon the theory that the purpose of the levy included equalization of loss as well as satisfaction of creditors.[41] The Chancellor, in limiting the assessment to the amount necessary to satisfy creditors, refused to exercise whatever theoretical power equity may have to protect the stockholder's interest in this manner upon the ground that the payment of the subscriptions for the benefit of the corporation and the stockholders was exclusively an internal matter between the stockholders and the board of directors with which the court had no concern.[42]

An analysis of the question of the power of a receiver to enforce contribution among stockholders must include recognition of the importance which applicable statutory provisions play in the judicial shaping of the procedure of the particular jurisdiction. Thus the denial of

[39] Del. Rev. Code 1915, sec. 1934, as amended by 36 Del. Laws, c. 135, sec. 11, p. 382:

"When the whole of the consideration payable for shares of a corporation shall not have been paid in, and the assets shall be insufficient to satisfy the claims of its creditors, each holder of such shares shall be bound to pay on each share held by him the sum necessary to complete the amount of the par value of such share as fixed by the charter of the company or its Certificate of Incorporation, or such proportion of that sum as shall be required to satisfy the debts of the corporation, or, in the case of stock without par value, this liability shall be limited to the unpaid balance of the consideration for which such shares were issued by the corporation."

[40] John W. Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 286, 101 Atl. 879 (1917), as modified by Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920).

[41] Carpenter v. Griffith Mortgage Corp., (Del. Ch. 1934) 172 Atl. 447.

[42] In reaching the decision judicial emphasis was placed upon that section of the statute providing that the capital stock of a corporation shall be paid in such amounts and at such times as the directors may require, and that the directors may, from time to time, assess upon each share of stock not fully paid up, such sum of money as the necessities of the business may, in the judgment of the board, require, not exceeding the balance remaining unpaid up to the par value, or in the case of no par stock, the consideration for which the stock was issued. Rev. Code 1915, sec. 1935, as amended by 29 Del. Laws, c. 113, sec. 11, p. 327. In view of this provision, the question of full payment of stock for the benefit of the corporation and stockholders was regarded as one exclusively in the judgment of the board of directors. Further, the neglect of the stockholders who had previously paid to compel board action in regard to these delinquent subscriptions was relied upon to deny the relief sought. As a final consideration, it was assumed that the corporation would continue business after the satisfaction of the creditors, at which time, the injured stockholders could secure equalization of their losses by the proper corporate action.

the receiver's full recovery in the law action in the *Phillips* case [43] was necessarily dictated by the statutory emphasis placed upon proportionate liability to creditors upon insolvency, and by the decision in *John W. Cooney & Co. v. Arlington Hotel Co.*[44] establishing the necessity of an assessment proceeding. As opposed to the *Phillips* case, numerous others, in the absence of any such statutory restriction, admit the power of the receiver to equalize the stockholder's losses by compelling the payment of the whole unpaid subscription.[45] Unless one is willing to question the wisdom and propriety of the different legislative schemes of subscriber's liability and the procedure for the enforcement thereof which have been imposed by the judiciary in the effectuation of the declared policy, the correctness of either of the above judicial attitudes toward the problem of the extent of the receiver's recovery from the delinquent subscriber cannot be questioned. From the standpoint, however, of an efficient and expeditious administration of the affairs of the debtor corporation, an adjustment of the conflicting interests involved may be accomplished more effectively by the judicial entertainment of the doctrine which allows a complete collection of the corporate assets by the injured stockholder in an independent suit. Upon this approach, the purpose of the receivership proceeding, whether for the liquidation of the corporation, or for the mere collection and conservation of the assets, should be a predominant factor in determining the extent of the receiver's recovery, for the interest of the stockholder in the equalization of the losses is not vital where a continuation of business after the satisfaction of creditors is contemplated. While the result of the *Phillips* case may be explained on that ground, the legal theory of the case and of other cases requiring the assessment proceeding does not recognize any such distinction based on the purpose of the receivership. Admitting the propriety of the levy, the limitation imposed upon the

[43] Philips v. Slocomb, (Del. 1933) 167 Atl. 698.

[44] 11 Del. Ch. 286, 101 Atl. 879 (1917), as modified by Du Pont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1920).

[45] See cases cited in note 27, supra. With the result reached under the Delaware statute and decisions, contrast the result reached by the judicial interpretation of the Kansas statute cited in Guilbert v. Kessinger, 173 Mo. App. 680, 160 S. W. 17 (1913). This statute provides in part:

> "'All collections made by the receiver shall be held for the benefit of all creditors, and shall be disbursed in such manner and at such times as the court may direct. Should the collections made by the receiver exceed the amount necessary to pay all claims against such corporation, together with all costs and expenses of the receivership, the remainder shall be distributed among the stockholders from whom collections have been made, as the court may direct; and in the event any stockholder has not paid the amount due from him, the stockholders making payment shall be entitled to an assignment of any judgment or judgments obtained by the receiver against such stockholder, and may enforce the same to the extent of his proportion of claims paid by them.'" Quoted, 173 Mo. App. 680 at 696.

power of the receiver by the court in the equity suit, *Carpenter v. Griffith Mortgage Corp.*,[46] seems questionable. General equitable principles and the desirability of settling the whole affair should have justified the equalization of the losses.[47] Judicial objection to the exercise of the equity power on the ground of the neglect of those stockholders who had made some payment to compel the full payment of the subscription while the corporation was a going concern is not convincing. The provision of the corporation statute relating to the propriety of calls upon unpaid stock by the board should not be regarded as an inherent limitation upon equity's power to compel the payment of stock subscriptions, for the application of the statute may fairly be restricted to the situation where the corporation is a going concern. Further, since complete satisfaction of creditors and continuation of the corporate business after insolvency is rare, it is hardly an answer to this suit to say that the stockholders may then compel the payment of the subscription delinquency.[48] The decision leads to multiple and expensive litigation.

The above principles are strictly limited to equalization of losses by enforcing contribution among the delinquents. Where, upon liquidation or dissolution, a fund remains to be distributed among the proprietary participants after the full payment of creditors, decisions generally require distribution in accordance with the principle of equality of right among stockholders.[49] To insure the equalization between classes of stock where the remaining amounts represent a loss in the

[46] (Del. Ch. 1934) 172 Atl. 447.

[47] Compare Wilcoxen v. Anderson, 197 Iowa 987, 197 N. W. 1009 (1924); 38 HARV. L. REV. 112 (1925), in which case a liquidating receiver was suing the delinquent subscribers for the sole purpose of equalizing the losses among stockholders, the creditors having been paid in full. The court, in rejecting the argument that general equity jurisdiction of the administration of the affairs of an insolvent corporation is a justification for the receiver's recovery of the unpaid subscriptions for the exclusive benefit of the injured stockholders, grounded the lack of equity power to entertain the suit upon the theory that the purpose and function of a receiver was limited to the administration of the assets for the benefit of creditors, and that, the purpose having been performed, personal rights and controversies among stockholders were of no concern to the receiver. By virtue of this restricted and rather technical approach of the court, multiple litigation which could be avoided by a contrary decision is inevitable. While in both this and the Carpenter case the receiver was denied recovery for the benefit of the stockholders, query whether, in view of the factual differences, this case furnishes much support for the position of the Delaware court in the Carpenter case. *Cf.* Lex v. Selway Steel Corp., 203 Iowa 792, 206 N. W. 586 (1925). Exactly *contra* to the stockyards case is Hartman v. Ins. Co. of Valley of Virginia, 32 Gratt. (73 Va.) 242 (1879). *Cf.* Pope v. Merchants' Trust Co., 118 Tenn. 506, 103 S. W. 792 (1907); In re Bass, (D. C. N. D. Ga. 1914) 215 Fed. 275.

[48] See note 42, supra.

[49] 16 FLETCHER, CORPORATIONS, Perm. ed., sec. 8224 (1933); 8 THOMPSON, CORPORATIONS, 3d ed., sec. 6544 (1927).

original paid in capital, the distribution must be based upon the amount which should have been paid for the stock rather than the amount actually paid; otherwise the partially paid stock does not bear its proportional share of the capital loss.[50] This equitable adjustment of the burden may be accomplished by a return to the holders of the fully paid shares of the difference between the amounts paid on their shares and the amounts paid on the partly paid shares; and a proportionate participation in the remaining fund on a par value basis.[51] Another method of equalization of loss, by compelling a theoretical contribution to the extent of the amount unpaid upon the subscription, involves an accounting calculation of the amount to be paid and received by each class of stock in view of the required contribution, and distribution and assessment accordingly.[52] Similarly, where a surplus above the amount of the paid-in capital exists, equality is guaranteed by a return of each subscriber's capital contribution and a proportionate share participation in the remainder.[53] The question of the stockholders' rights upon the distribution of corporate funds may become acute in case of a business revival; a receiver in possession of corporate assets may suddenly find that a business boom has increased the value of the assets to such an extent that his problem becomes one of distribution to the proprietors of the business rather than the collection of assets sufficient only to satisfy creditors.

H. F. B.

[50] Pennington v. Commonwealth Hotel Const. Corp., 17 Del. Ch. 188, 151 Atl. 228 (1930), aff'd 17 Del. Ch. 394, 155 Atl. 514 (1931); Krebs v. Carlisle Bank, (C. C. E. D. Penn. 1850) Fed. Cas. 7932; Hartman v. Ins. Co. of Valley of Virginia, 32 Gratt. (73 Va.) 242 (1879). *Cf.* Jones v. Henderson, 210 Ala. 614, 98 So. 878 (1924).

The situation of unequally paid stock is common in England, for the English Companies Act does not require payment of the full consideration. Equality among the classes of stock upon distribution where there is a capital loss is well recognized by English decisions. In re Hodges' Distillery Co.: Ex parte Maude, L. R. 6 Ch. App. 51 (1870); In re Anglo-Continental Corp., [1898] 1 Ch. 327, with which compare In re Kinetan (Borneo) Rubber, Ltd., [1923] 1 Ch. 124. See 35 A. L. R. 493 (1925).

[51] Krebs v. Carlisle Bank, (C. C. E. D. Pa. 1850) Fed. Cas. 7932; In re Hodges' Distillery Co.: Ex parte Maude, L. R. 6 Ch. 51 (1870).

[52] Pennington v. Commonwealth Hotel Const. Corp., 17 Del. Ch. 188, 151 Atl. 228 (1930), aff'd 17 Del. Ch. 394, 155 Atl. 514 (1931).

[53] In re The Bridgewater Navigation Co., Ltd., 14 A. C. 525 (1889); In re Driffield Gas Light Co., [1898] 1 Ch. 451; dictum in Weber v. Nichols, 75 N. J. Eq. 117, 75 Atl. 997 (1908). *Contra,* Grone v. Economic Life Ins. Co., (Del. Ch. 1911) 80 Atl. 809; Ins. Co. v. Dunscombe, 108 Tenn. 724 (1902), in which cases the stockholders were held to be entitled to participation in such proportion as the subscriptions have been paid. Considerable doubt is cast upon the decision in the Grone case by the Chancellor in the case of Pennington v. Commonwealth Hotel Const. Corp., 17 Del. Ch. 188, 151 Atl. 228 (1930).