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STOCKHOLDERS' LIABILITY IN MINNESOTA

BY HENRY W. BALLANTINE*

JUSTICE Canty, in a case involving a construction of the Minnesota statutes as to the liability of officers and members for corporate debts, significantly said:¹

"Each case adds new proof to what has been so often remarked,—that the statutes of this state regulating corporations are crude, unsatisfactory and in conflict with each other, and it is often difficult to spell out the real intent of the legislature."

Since some thorough-going revision of our corporation laws, similar to that of Illinois in 1919, ought to be undertaken at an early date, it may be of interest to attempt a survey of the important and complex topic of stockholders' liability. It will be convenient to take up *first*, the peculiar situation presented by the absence of any requirement of subscription to capital stock as a condition to the transaction of business, *second*, the rights of creditors against shareholders with respect to bonus and watered stock, which will involve a discussion of the so-called "trust fund doctrine;" *third*, the rights of creditors against shareholders by reason of the constitutional or double liability; and *fourth*, the remedies and methods of enforcement of the two principal kinds of stockholders' liability.

I. ANOMALY OF CORPORATIONS WITHOUT STOCKHOLDERS.

The exemption of the stockholders from unlimited liability is "the corporation's most precious characteristic," which makes

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¹National New Haven Bank v. Northwestern Guaranty Loan Company, (1895) 61 Minn. 375, 386, 63 N.W. 1079.

the corporation the greatest factor in modern business. What is the security which the law exacts as the condition upon which it grants this special corporate privilege, viz: the right to incur liabilities for the discharge of which the persons owning the business are not liable as partners? A startling gap in this respect is revealed in the recent decision of *Moe v. Harris*.² The plaintiffs having recovered judgment against the Yale Mining Company for services rendered, sued the three individuals who had attempted to organize the corporation. The defendants were named in the articles as directors and officers of the corporation to serve until their successors were elected. The theory of the action was that the pretended corporation was a hollow mockery in view of the fact that no stock had ever been subscribed or paid for, and it was urged that the defendants were simply co-partners doing business under the guise of a corporation.

The decision was in favor of the defendants on the ground that when the organization of the corporation has been completed, as required by statute, a corporation de jure is brought into existence notwithstanding the fact that no capital stock has been subscribed or paid for, no books kept, no by-laws adopted, no meetings held or officers elected.

"The statute does not make it a condition precedent to the right of the corporation to transact business, that all or any of its authorized capital stock shall be subscribed or paid in."

How can there be a corporation without capital stock or stockholders? The statute does not require that the incorporators should be subscribers to stock. They have no interest whatever in the company to be formed. As the Pennsylvania Court says:³

"They are mere instruments of the law for purposes of preliminary organization. The moment that is accomplished . . . the necessary certificates signed and the charter granted they are functi officio. The corporation is thenceforth composed of stockholders."

But if there are no subscribers or stockholders of what is the corporation composed? It is indeed an imaginary and fictitious entity without body or soul or pocket book, existing only in contemplation of the law, "a speculative bubble, ready to explode into thin air at the first touch of adversity." Those designated as directors and officers are not members unless they are stockholders but are merely agents.

²(1919) 142 Minn. 442, 172 N. W. 494.

³Densmore Oil Co. v. Densmore, (1870) 64 Pa. 43.

The statement in the articles or certificate of incorporation that the capital stock is a designated amount divided into a certain number of shares, each of a named par value, creates neither shares nor capital stock. It expresses the power of the corporation to acquire a capital stock; it creates potential shares; it fixes the amount of the contribution required from the holder of a share.⁴

Corporations for profit organized under the present laws of Minnesota must have at least \$10,000 authorized capital stock, divided into shares having a nominal or par value of not less than \$1.00.⁵ But apparently by oversight, there is no requirement that any minimum amount of stock be subscribed or paid in as a condition of doing business. The statutes permit a corporation to incur debts without any capital or corporate fund or resources of any sort answerable for their payment.

By the corporation laws of many states the subscription and payment of a minimum capital stock is required before the transaction of business, and persons who organize corporations and transact business as corporations without this are made liable to creditors.⁶ Statutory regulations as to banks and financial corporations invariably require that actual capital to a certain amount be subscribed and paid in before business is begun or indebtedness created.⁷ In addition to this, in national banks and most state banks there is a superadded liability equal to the face value of the stock. Thus two hundred dollars is placed behind every one hundred dollars of issued stock as security for deposits and other debts of the corporation.

Stockholders take the profits and hence should take some of the risks of the business. They are exempted from personal liability upon the supposition that they will make some contribution to the capital of the corporation. A corporation without any subscribed or paid in stock is "a ghost, a fraud per se, a

⁴U.S. Radiator Co. v. New York, (1913) 208 N.Y. 144, 152, 101 N.E. 783, 46 L.R.A. (N.S.) 585.

⁵Minn. G.S. 1913, sec. 6181.

⁶14 C.J. 980, 982; Walton v. Oliver, (1892) 49 Kan. 107, 30 Pac. 172, 33 A.S.R. 355; Heinze v. South Green Bay L. Co., (1901) 109 Wis. 99, 85 N.W. 145; Badger Paper Co. v. Rose, (1897) 95 Wis. 145, 70 N. W. 302; John V. Farwell Co. v. Jackson Stores, (1911) 137 Ga. 174, 73 S.E. 13; Wells v. Ivey, (1916) 144 Ga. 548, 87 S. E. 661; Ames v. McCaughey, (1913) 88 Ohio 297, 102 N.E. 989; Thompson, Corps. sec. 4732.

⁷Minn. G.S. 1913, Sec. 6142, 6348, 6365, 6372, 6405. See also Minn. Laws 1921, ch. 23, sec. 3.

licensed pirate without fear of capture and execution."⁸ The legislative grant of limited liability is made very freely in this country, but as is well said in the New Jersey case of *See v. Heppenheimer*:⁹

"Men of business, who transact their business under the shield of a corporate existence, have the great and peculiar advantage over those trading as individuals of avoiding personal pecuniary liability. If the enterprise is prosperous, they make and enjoy its gain. If, on the other hand, it is not prosperous, they lose only their original investment, which may be a part only of their individual fortunes, and any loss beyond that investment falls on the unfortunate creditors. This involves apparent, if not real, unfairness in trade. Be that as it may, under these conditions, surely the investors in the stock of trading corporations ought not to complain or ask any sympathy if the courts of the country hold them to a strict compliance with the terms of the law under which they claim immunity from pecuniary responsibility."

II. RIGHTS OF CREDITORS AGAINST STOCKHOLDERS WITH RESPECT TO WATERED AND BONUS STOCK.

A creditor may seek to collect his debt on the basis of the liability of the stockholder to pay the par value of his stock under various circumstances: (1) Where an unpaid balance is due the corporation upon his subscription contract; (2) where he has received dividends out of capital assets; (3) where the shares were issued as a bonus or at a discount with no contract to pay more; (4) where the shares were issued as full paid in exchange for property or services fictitiously valued, in other words for a consideration diluted with water or blue sky.

It is important to observe that there are two sorts of obligation to pay up on stock not paid for dollar for dollar at the time of issue. The first is a contractual obligation of the stockholder to the corporation to pay the subscription price or any unpaid installment thereof. It is clear that the "indebtedness of stockholders upon subscriptions to stock held by them is an indebtedness, not to the creditors of the corporation, but to the corporation itself. Such indebtedness is an asset of the corporation."¹⁰ The second kind of obligation has a different basis. It is not usually regarded as a contractual obligation or as an asset of the corporation. It is an equitable obligation enforced by the courts

⁸Cook, 7 Am. Bar Ass'n Jnl. 534.

⁹(1905) 69 N.J. Eq. 36, 49, 61 Atl. 843.

¹⁰In re Peoples Livestock Insurance Co., (1893) 56 Minn. 180, 185, 57 N.W. 468; 5 Fletcher Corps. 3455.

in favor of creditors where the corporation itself would have no right, and contrary to the actual agreement of the stockholder. It is the source or basis of this obligation to creditors to pay up the par value of bonus or watered stock which it is difficult to explain.

In *First National Bank of Deadwood v. Gustin Minerva Mining Co.*,¹¹ Justice Mitchell clearly points out the above distinction. If stockholders are indebted to the corporation for unpaid installments on stock, this debt is an asset of the corporation which, in case it becomes insolvent, any creditor may enforce for the purpose of satisfying his claim. This might be by a creditor's bill in the nature of an equitable execution. But where stock is sold at a discount or is given away as full-paid, it is very clear that the stockholder owes the corporation nothing. As between the corporation and the stockholder the arrangement by which the stock is issued as full-paid stock is entirely valid. Upon what ground is it then held that the arrangement, although valid against the company, will be ineffectual against the creditor? Upon what ground will equity hold the shareholder liable to pay up the full par value, if necessary to satisfy the debts of the corporation? What is the source of the equitable right of the creditor to insist on a contribution of a greater amount of capital by the shareholder than he has agreed to contribute?

The New York courts deny that there is any such liability. As is said in the case of *Christianson v. Eno*:¹²

"But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute. . . We do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the nominal face of the shares as upon a subscription or contract."

It seems then that by the law of New York (although recognizing the trust fund doctrine) the subscription agreements are the source and measure of the duty of the subscribers.¹³

In an article entitled, *The Trust Fund Theory and some Substitutes for It*,¹⁴ Mr. Edwin S. Hunt comes to the conclusion

¹¹(1890) 42 Minn. 327, 6 L.R.A. 676, 44 N.W. 198, 18 A.S.R. 510.

¹²(1887) 106 N.Y. 97, 60 Am. Rep. 429.

¹³*Southworth v. Morgan*, (1912) 205 N.Y. 293, 98 N.E. 490.

¹⁴12 Yale L. J. 63, 81. See also *Wickersham, The Capital of a Corporation*, 22 Harv. L. Rev. 319, 322.

that there is no principle of law or of equity upon which a creditor can compel a stockholder to pay more for his stock than he has agreed to pay. He believes that the liability of stockholders beyond their agreements is a matter for statutory regulation, in accordance with the New York view; that unissued stock is not assets and that a person accepting shares as a gratuity or at a discount has not injured the creditors, prior or subsequent.

Most courts recognize that there is such a liability upon the original holders of bonus or watered stock or their transferees with notice.¹⁵ There is much difference of opinion, however, as to the principle upon which this liability to creditors rests and whether it should be limited to subsequent creditors without notice. This liability has been accounted for on various theories; first upon the trust fund theory originated by Judge Story in 1824 in the case of *Wood v. Dummer*,¹⁶ second, the fraud theory, the presumed reliance of the creditor upon the issued capital stock of the corporation;¹⁷ third, the co-debtor theory, to the effect that the stockholders are in reality co-debtors up to the limit set by the par value;¹⁸ and fourth, the prescribed obligation theory, that an obligation to contribute an amount equal to the par value is imposed by operation of law as an incident of acquiring membership in a corporation.¹⁹

The trust fund theory is the one most commonly advanced. As stated in *Farnsworth v. Robbins*,²⁰ a case involving the release of a subscriber and a discharge of his obligation to pay upon surrender of his stock, "the capital stock of a corporation contributed or agreed to be contributed by its stockholders, is in equity and as to creditors, deemed a trust fund charged with the payment of the debts of the corporation, and must be treated as such by the corporation."²¹

¹⁵*Wallace v. Carpenter, etc. Co.*, (1897) 70 Minn. 321, 73 N.W. 189, 65 A.S.R. 530.

¹⁶(1824) 3 Mason (C.C.) 308, Fed. Cas. No. 17, 944.

¹⁷*Hospes v. Northwestern Trust Co.*, (1892) 48 Minn. 174, 50 N.W. 1117, 31 A.S.R. 637, 51 L.R.A. 470.

¹⁸56 Univ. Penn. L.Rev. 57.

¹⁹*Pepper*, 34 Am. L. Reg. (N.S.) 448, 457; 29 Harv. Law Rev. 857; *Warren*, 34 Harv. Law Rev. 287.

²⁰(1887) 36 Minn. 369, 371, 31 N.W. 349. See also *Ross v. Kelly*, (1886) 36 Minn. 38.

²¹Citing *Upton v. Tribilcock*, (1875) 91 U.S. 45, 23 L. Ed. 203; *Sanger v. Upton*, (1875) 91 U.S. 56, 23 L. Ed. 220; *Sawyer v. Hoag*, (1873) 17 Wall. (U.S.) 610, 21 L. Ed. 731; *Clapp v. Peterson*, (1882) 104 Ill. 26; *Crandall v. Lincoln*, (1884) 52 Conn. 73; *Adler v. Milwaukee, etc., Mfg.*

In the case of *Wood v. Dummer*,²² in which a bank had divided up two-thirds of its capital stock among its stockholders without providing funds sufficient to pay its debts, Mr. Justice Story pointed out that the charter of a corporation relieves the stockholders from personal responsibility and substitutes the capital stock in its stead. Credit is universally given to this fund by the public as the only means of repayment. Accordingly contributions cannot be withdrawn without payment of the debts.

The reason for the trust fund theory is well stated in *Sanger v. Upton*.²³

"The capital stock of an incorporated company is a fund set apart for the payment of its debts. It is a substitute for the personal liability which subsists in private co-partnerships . . . The creditors have a lien upon it in equity. If diverted they may follow it as far as it can be traced."

Mr. Justice Miller said in *Sawyer v. Hoag*:²⁴

"We think it now well established that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation."

The capital of a corporation may perhaps be regarded as a trust fund in the sense that it cannot be diverted or distributed among the stockholders without provision being first made for full payment of corporate debts.²⁵ As said by Mr. Pomeroy:²⁶

"These statements may be sufficiently accurate as strong modes of expressing the doctrine that such property is a fund sacredly set apart for the payment of partnership and corporation creditors, before it can be appropriated to the use of individual partners or corporators."

The principal office of the trust fund doctrine is to preserve the capital of a corporation as a fund for the payment of its debts against withdrawal by stockholders.²⁷ It fails to explain the right of creditors where the corporation has no res to hold in trust, no asset or right against the stockholder such as a contract to pay the par value. A trust may be impressed upon un-

Co., (1860) 13 Wis. 57; 2 Morawetz. Corps. 780, 781, 790, 820. See also *Hatch v. Dana*, (1879) 101 U.S. 205, 210, 25 L.Ed. 885; *Scoville v. Thayer*, (1881) 105 U.S. 143, 26 L.Ed. 968; *Camden v. Stuart*, (1892) 144 U.S. 104, 36 L.Ed. 363, 12 S.C.R. 585.

²²(1824) 3 Mason (C.C.) 308; 30 Fed. Cas. No. 17, 944.

²³(1875) 91 U.S. 56, 23 L.Ed. 220.

²⁴(1873) 17 Wall. 610, 21 L.Ed. 731.

²⁵*Lebens v. Nelson*, (1921) 148 Minn. 240, 245, 181 N.W. 350; *Mackall v. Pocock*, (1917) 136 Minn. 8, L.R.A. 1917C 397, 161 N.W. 228.

²⁶3 Pomeroy, Eq. Jur. 4th. Ed. Sec. 1046.

²⁷*Upham v. Bramwell*, (Or. 1922) 209 Pac. 100, 121; *Mackall v. Pocock*, (1917) 136 Minn. 8, 12, 161 N.W. 228, L.R.A. 1917C 390, 397, 399.

paid subscriptions to stock, but where the stockholder is under no subscription obligation to the corporation itself what is there for the corporation to hold in trust?²⁸ Issuing shares wholly or partly as a bonus is not a disposition of corporate assets like paying dividends out of capital, because unissued stock is no asset. The statement of authorized capital stock in the certificate creates merely authority to raise capital.

In the leading case of *Hospes v. Northwestern Mfg. & Car Co.*,²⁹ Judge Mitchell in one of his most celebrated opinions, criticized and in effect repudiated the trust fund theory at least as the foundation of the stockholders' liability on watered or bonus stock. He placed this liability on the basis of fraud, actual or constructive. Prior to the *Hospes case*, as we have seen, the Minnesota court had recognized the trust fund doctrine, and for certain purposes, at least, particularly to prevent withdrawal of capital, it is no doubt still operative in this state.³⁰ Both the trust fund and the fraud doctrines are recognized in Illinois and enforced where applicable.

In the *Hospes case* the Minnesota Thresher Mfg. Co., filed a complaint in the insolvency proceedings pending against the Northwestern Mfg. and Car Co., against one hundred or more stockholders of the insolvent corporation to compel them to pay to the receiver the face value of the common stock issued to them as a bonus. In passing upon the nature and basis of the liability of the holders of watered stock, Judge Mitchell denied the necessity or expediency of inventing any such theory as the trust fund doctrine.

According to Judge Mitchell the right of creditors to compel holders of bonus stock to pay for it, contrary to their actual agreement with the corporation, rests neither upon implied contract nor upon any trust fund doctrine, but upon the ground of fraud. The fraud consists in the misrepresentation as to the actual amount of capital, upon the faith of which persons have dealt with a corporation and given it credit. Since it is only those creditors who have relied on, or who can fairly be pre-

²⁸*O'Bear Jewelry Co. v. Volfer & Co.*, (1894) 106 Ala. 205, 17 So. 528, 28 L.R.A. 707; 20 Harv. L. Rev. 401; 6 Fletcher, Corp. sec. 4095.

²⁹(1892) 48 Minn. 174, 50 N.W. 1117. 31 A.S.R. 637, 51 L.R.A. 470.

³⁰*Farnsworth v. Robins*, (1887) 36 Minn. 369, 371, 31 N.W. 350; *Mackall v. Pocock*, (1917) 136 Minn. 8, 161 N.W. 228. In L.R.A. 1917C 397 the annotator speaks of this case as a virtual abandonment of the attitude of Justice Mitchell in the *Hospes case*, in other words a recognition of the trust fund theory. *Johnson v. Canfield-Swigart Co.*, (1920) 292 Ill. 101, 126 N.E. 608; 15 Ill. L. Rev. 217.

sumed to have relied on, the stock representing actual capital, who can claim an equity to enforce payment of such stock, payment can never be enforced in favor of one who became a creditor before the bonus stock was issued. As to subsequent creditors, it is also a matter of defense to show that the creditor had knowledge of the arrangement by which the bonus stock was issued, which negatives the presumption that he gave credit on the faith of it.

In *First National Bank of Deadwood v. Gustin Minerva Mining Co.*,³¹ it was laid down by Judge Mitchell that:

"It is only those creditors who can fairly allege that they have relied, or whom the law presumes to have relied, upon the amount of capital stock of the company, who have a right to make such inquiry, or in whose favor equity will impress a trust upon the subscription to the stock, and set aside a fictitious arrangement for its payment. . . . Where corporations have organized and engaged in business with a certain amount of ostensible and professed paidup capital, but which was not in fact paid in, there are numerous cases in which the courts have set aside the arrangement by which the stock was called 'paid-up,' and impressed a trust upon the subscription of the shareholder in favor of subsequent creditors who relied upon, or whom the law would presume to have relied upon, the apparent and professed amount of capital."³²

"If a corporation issue new shares after the claim of the creditor arose, it is clear that the latter could not have dealt with the company on the faith of any capital represented by them. Whatever was contributed as capital in respect of the new shares was a clear gain to the creditor's security."

"So, too, if a party deals with a corporation with full knowledge of the fact that its nominal paid-up capital has not in fact been paid for in money or property to the full amount of its par value, he deals solely on the faith of what has been actually paid in and has no equitable right to insist on the contribution of a greater amount of capital by the shareholder than the corporation itself could claim as part of its assets."³³

This idea of fraud is again emphasized by Chief Justice Start in *Wallace v. Carpenter Electric Heating Mfg Co.*,³⁴ which was an equitable action by judgment creditor to enforce payment of

³¹(1890) 42 Minn. 327, 333, 44 N.W. 198, 18 A.S.R. 510, 6 L.R.A. 676. .

³²Citing *Sawyer v. Hoag*, (1873) 17 Wall. 610, 21 L.Ed. 731; *Wetherbee v. Baker*, (1882) 35 N.J.Eq. 501.

³³Citing *Coit v. Gold Amal. Coal Co.*, (1882) 14 Fed. 12; affirmed 119 U.S. 343, 30 L.Ed. 420, 7 S.C.R. 231.

³⁴(1897) 70 Minn. 321, 73 N.W. 189, 68 A.S.R. 530. See, also, *Randall Pr. Co. v. Sanitas Water Co.*, (1913) 120 Minn. 268, 139 N.W. 606; *Downer v. Union L. Co.*, (1911) 113 Minn. 410, 416, 129 N.W. 777; *State Bank v. Kenny, etc., Co.*, (1919) 143 Minn. 236, 173 N.W. 560.

his judgment by a stockholder of the debtor corporation on the ground that its stock was fraudulently issued as fully paid up when in fact it was not. Start C. J. declares that the issuing of stock as fully paid up when in fact it is not, is a cheat and a fraud which enables a corporation to obtain credit and property by false pretenses and misrepresentation of its assets.

Probably the most important consequence of the fraud or holding out theory is the limitation of the stockholders' liability on watered or bonus stock to subsequent creditors without notice. This limitation is observed in a majority of jurisdictions.³⁵ But in some states the creditor may recover from the stockholder even though he extended credit prior to the issue of the stock or with full knowledge that the subscription was not paid in full.³⁶ This result is usually based in part at least on statutory construction. But it could also be reached as a matter of common law if the right of the creditor is really derived through an obligation owed to the corporation, and does not accrue to the creditor directly upon a kind of tort liability in the nature of deceit. It should be noted that the statutory double liability is imposed both in favor of prior and subsequent creditors.

In *Easton National Bank v. American Brick & Tile Co.*,³⁷ it is held that under the New Jersey General Corporation Act of 1875, a creditor's knowledge that stock was improperly issued as "full paid" and as "issued for property purchased," when the fact was otherwise, is not sufficient to debar him from relief against recipients of the stock. As Pitney, J. says, if the only foundation of the stockholders' liability to creditors is that of

³⁵See Minn. cases cited above; also *Sherman v. Harley*, (1918) 178 Cal. 584, 174 Pac. 901, 7 A.L.R. 950; *Hill v. Silvey*, (1888) 81 Ga. 500, 8 S.E. 808, 3 L.R.A. 151; *First National Bank of Chanute v. Northrup*, (1910) 82 Kan. 638, 109 Pac. 672, 136 A.S.R. 119; *Scott v. Luehrman*, (1919) 278 Mo. 638, 213 S.W. 855; *Shields v. Clifton Hill Land Co.*, (1894) 94 Tenn. 123, 154, 28 S.W. 668 but see *Jones v. Whitworth*, (1895) 94 Tenn. 602, 30 S.W. 736; *Gogebic Inv. Co. v. Iron Chief Co.*, (1891) 78 Wis. 427, 47 N.W. 726, 23 A.S.R. 417; *Thompson, Corps*, sec. 3945, 3983; 2 *Morawetz, Corporations* sec. 829.

³⁶*Easton National Bank v. American B. & T. Co.*, (1906) 70 N. J. Eq. 732, 64 Atl. 917, 8 L.R.A. (N.S.) 271; *J. W. Cooney Co. v. Arlington Hotel Co.*, (1917) 11 Del. Ch. 286, 101 At. 879, 890; *Dupont v. Ball*, (1918) 11 Del. Ch. 430, 106 At. 39, 7 A.L.R. 955; *Sprague v. National Bank*, (1898) 172 Ill. 149, 50 N.E. 19, 42 L.R.A. 606, 64 A.S.R. 17; *Gillett v. Chicago, etc., Co.*, (1907) 230 Ill. 373, 82 N.E. 891; *Rosoff v. Gilbert Transportation Co.*, (1915) 221 Fed. 972, (Under Conn. Statute).

³⁷(1906) 70 N.J. Eq. 743, 64 Atl. 921, 10 Ann. Cas. 84, 8 L.R.A. (N.S.) 271. See *Volney v. Nixon*, (1905) 68 N.J. Eq. 605, 60 Atl. 189.

having held out the issued stock as a source from which payment might be expected, then it would not be irrational to debar from any claim creditors whose claims accrued prior to the stock issue in question, and subsequent creditors who had notice. But in New Jersey, stockholders' liability upon watered stock does not depend on the theory of fraud or "holding out." It depends upon the stockholders' statutory obligation that the stock subscription be made good for the benefit of creditors of insolvent companies. The obligation is owed by the holders of watered stock without distinction between prior and subsequent creditors, or between creditors who have had notice and those who had none. Watered stock, under whatever device, is absolutely alien to the statutory policy of the state, which prohibits that stock be issued without the receipt of an equivalent in value.

It is submitted that the constructive fraud doctrine, as laid down in the *Hospes case* and the subsequent Minnesota cases, is no more sound or satisfactory as a basis for the stockholders' liability than the trust fund doctrine. In the first place the stockholder, by accepting a certificate of watered stock doesn't make any actual representation to the creditor that he has paid for the stock in full and it seems difficult to convict him of having participated in any.³⁸ As a general thing the creditor doesn't know how much of the authorized capital stock has been actually issued.

In the second place it seems a pure fiction to say, as Morawetz and many courts have said, that the amount of capital stock is fixed for the purpose of obtaining commercial credit by indicating to the community what security has been provided for those who deal with the corporation.³⁹ The amount of authorized capital stock of a corporation is usually fixed partly with a view to the maximum amount of capital to be raised by an issue of stock, and partly in view of the organization and annual franchise taxes which are levied on the basis of the amount of authorized capital. According to the fraud theory each stockholder represents to every creditor that for each share of stock issued to him 100% par value has actually been paid into the treasury of the company.

Various writers on non-par stock have clearly pointed out that as a business reality the amount of outstanding stock pur-

³⁸See Hunt, Trust Fund Theory, 12 Yale L. J. 63.

³⁹See 2 Morawetz, Corp. Sec. 781.

porting to be fully paid up affects the question of corporate credit very little, if at all. The time has gone by, if it ever existed, when creditors rely on the professed capitalization rather than upon the real financial condition in extending credit.⁴⁰

The fictitious basis of this fraud doctrine clearly appears when we find that the supposed reliance of the creditor is *presumed* and that public policy requires that the fact whether a particular creditor did or did not trust the corporation on that basis should not be inquired into.⁴¹ It is apparent from this that the rule is really based upon reasons of convenience, public policy, and practical justice and that the supposed fraud is fraud in law or imaginary fraud rather than actual fraud. In other words it is merely a name for something else.

The capital stock of a corporation is the basis of its credit, not because of actual reliance by creditors on the precise amount of stock issued, but because the contributions of the stockholders are the substitute for their personal liability. It is not any misrepresentation of fact as to the amount of paid-in capital which is the basis of liability, but the obligation imposed by law on the stockholder to contribute capital as an incident of membership in a limited liability corporation. This obligation is in the nature of an asset of the corporation and should be available to prior creditors and to subsequent creditors with notice as well as to those whose debts were contracted after the subscription without notice. The law assures to those dealing with the company, where the liability is limited, that the whole of the subscribed capital shall remain available for the discharge of its liabilities, except as diminished by losses and expenditures in the course of business. Capital may be lost in carrying on the business and the stockholder is not bound to replace it or keep it unimpaired except in banks and financial corporations; but he cannot escape his obligation to contribute by any fictitious arrangement with the corporation or by withdrawing his contribution to the prejudice of creditors.⁴²

⁴⁰Bank v. Belington Co., (1902) 51 W. Va. 60, 41 S.E. 390; State v. Sullivan, (1920) 282 Mo. 261, 221 S.W. 728; 1 Machen, Corp. sec. 786; Rice & Harno, Shares With No Par Value, 5 MINNESOTA LAW REVIEW, 494.

⁴¹Dwinnell v. Minn. F. & M. Ins Co., (1906) 97 Minn. 340, 347, 106 N.W. 312; Randall Printing Co. v. Sanitas Water Co., (1913) 120 Minn. 268, 139 N.W. 606, 43 L.R.A. (N.S.) 706; R. H. Herron Co. v. Shaw, (1913) 165 Cal. 668, 133 Pac. 488, Ann. Cas. 1915A 1265.

⁴²See Buck v. Ross, (1896) 68 Conn. 29, 31, 35 Atl. 763, 57 A.S.R. 60; Handley v. Stutz, (1891) 139 U.S. 417, 35 L. Ed. 227, 11 S.C.R. 530; Minn. G.S. 1913, sec. 6193.

The true theory of stockholders' liability upon watered and bonus stock thus appears to be that of an obligation imposed by law on original subscribers and purchasers with notice to make a contribution to capital for the benefit of creditors as an incident of membership in the corporation.⁴³ On this theory the stockholder becomes liable without the aid of any fiction of reliance by the creditor on the professed capital. It may be that in imposing such an obligation the courts have been doing legislative work but it is in line with the general policy of the law as to corporations. No one can justly expect to become a member of a corporation and share in the profits of the enterprise without taking some financial responsibility and contributing his share of the capital.⁴⁴

As Judge Mitchel says in *Hospes v. Northwestern Mfg. & Car Co.*:⁴⁵

"The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with and give their credit on the faith of it. They have a right to assume that it has paid in capital to the amount it represents itself as having."

The law accordingly says to the would be stockholder:

"You are not entirely without responsibility for the debts of this enterprise. You must make a contribution of capital to the business to the par value of the stock issued to you as a burden incident to holding such stock, at least where needed to meet the claims of creditors."

No better criterion or standard of limited liability is to be found ready-made than the par value of the stock, as it represents the proportionate interest in the business and the proportion in which the owner should contribute to pay the debts.

An issue of watered stock should be looked at as a double-barrelled transaction: (1) A subscription to the stock, which imposes an obligation to pay the par value; (2) a separate agreement between the subscriber and the corporation that the shares shall be deemed fully paid for an inadequate equivalent, which is to be regarded as a release or conveyance of the claim of the corporation fraudulent as to creditors.

⁴³See Pepper, 34 Am. L. Reg. (N.S.) 448, 457, 459.

⁴⁴Gordon v. Cummings, (1914) 78 Wash, 515, 139 Pac. 489; Holcombe v. Trenton White City Co., (1912) 80 N.J.Eq. 122, 82 Atl. 698.

⁴⁵(1892) 48 Minn. 174, 197, 50 N.W. 1117. 31 A.S.R. 637, 15 L.R.A. 470; Wetherbee v. Baker, (1882) 35 N.J.Eq., 501, 511.

While it is very true that the stockholder who takes stock at fifty cents on the dollar does not defraud or do wrong to prior creditors, but whatever he contributes is a clear gain to them, still there is as much reason or justification for holding him upon the obligation to pay up the balance of the par value for the protection of prior as for the protection of subsequent creditors. In reality he does no fraud or wrong to subsequent creditors either. The obligation is a positive one imposed by law; it is an asset of the corporation, in its true nature; and the release of this obligation without fair equivalent, while valid against the corporation, is in effect a fraudulent conveyance as against all creditors in event of subsequent insolvency, because it deprives the corporation of the prescribed basis of financial responsibility, which is demanded by the policy of the law as the price of limited liability. The duty to contribute is an asset of a corporation which may be called a trust fund in the sense that the corporation cannot dispense with or release it as against creditors.

The obligation to contribute capital is theoretically not discharged by fictitious payment. Very often, however, in order to wash out of the watered or bonus stock the danger of liability to pay up its par value to creditors in event of insolvency, the organizers go through a solemn ceremony of legal hocus pocus which is supposedly sufficient to deceive the fiction-loving eye of the law, and which has become a part of the customary rigamarole of corporate organization and stock issues.

The entire authorized capital stock is commonly issued to the promoters by the dummy directors in payment for a mine, a lease, an oil well, a patent, an option, or some other consideration of uncertain value. The fiction consists in the determination by the directors that the value of the property thus acquired is the same as the par value of the stock issued in exchange for it. But the fact that the promoter, as part of the transaction, graciously donates back to the corporation as "treasury stock" a large portion of the stock for which he has just paid in full, shows that the valuation of the property is excessive. It is supposed that the stock can now be sold to the public for less than par as fully paid up and non-assessable, although upon an original issue a liability would attach for the unpaid balance.

The question then arises, what showing will the courts require to set aside the arrangement as a fraud upon creditors? In some jurisdiction the so called "*true value rule*" has been adopted

by the courts. According to this rule, payment for capital stock with property is no payment except to the extent of the true value of the property. If property is taken at an overvaluation the stockholder is liable to make up the deficiency and perform his obligation to give money or money's worth to the full amount of the par value of the stock taken.⁴⁶ In other jurisdictions a more lenient standard called the "good faith rule," has been adopted. By this rule the determination by the directors is conclusive unless fraud or intentional or reckless overvaluation can be shown.⁴⁷

This rule seems to be the one adopted in Minnesota. In *Hastings Malting Co. v. Iron Range Brewing Co.*,⁴⁸ it is said:

"The value of the property is to be determined, not from subsequent events, but as of the time of the transaction, and from the situation, nature, and condition of the property as they honestly appeared to the parties at the time. Although there was in fact an over valuation, it will not render the stockholders liable for the deficiency if it was the result of an honest mistake or error of judgment."

The test is whether the stockholder was justified in believing, in the exercise of ordinary business sense, that the property was being turned in at fair valuation. This will often turn on whether the value of the property is capable of being readily estimated or ascertained. In *Randall Printing Co. v. Sanitas Mineral Water Co.*,⁴⁹ it is said, "a corporation may in good faith issue paid up shares for the purchase of property or for services actually rendered." But equity will inquire into any fictitious arrangement by which stock is issued as fully paid up as a fraud on subsequent creditors without notice. In *State Bank v. Kenny etc. Co.*, it is said that:⁵⁰

"When stock is issued as fully paid upon a grossly inadequate consideration in property transferred, stockholders receiving it will be required to pay the difference between what they paid and par if subsequent creditors who have actually or presumably relied upon the stock as fully paid, require it for the satisfaction of their debts."

⁴⁶*Wm. E. Dee Co. v. Proviso Coal Co.*, (1919) 290 Ill. 252, 125 N.E. 24, 26; *Lanz v. Moeller*, (1913) 76 Wash. 429, 136 Pac. 687, 50 L.R.A. (N.S.) 68; 14 C.J. 961.

⁴⁷*Coit v. Gold Amalgamating Co.*, (1886) 119 U.S. 343, 30 L. Ed. 420, 7 S.C.R. 231; 5 Fletcher, Corp. sec. 3576. *Clinton Mining & Mineral Co. v. Jamison*, (1919) 256 Fed. 597, 167 C.C.A. 607; 14 C.J. 962.

⁴⁸(1896) 65 Minn. 28, 34, 67 N.W. 652.

⁴⁹(1913) 120 Minn. 268, 274, 139 N.W. 606, 43 L.R.A. (N.S.) 706.

⁵⁰(1919) 143 Minn. 236, 173 N.W. 560.

In some jurisdictions additional stock may be issued by a going concern at its market value irrespective of its par value, or the corporation may issue bonus stock in aid of the sale of bonds.⁵¹ Where money is contributed for stock to keep an embarrassed corporation going in the hope of paying its debts, it would be clearly unjust to hold that creditors are entitled to recover more than the amount agreed to be paid.⁵² So it has been held that stock may be issued at its full market value to pay corporate debts without obligation to pay up the par value.⁵³ As Mr. Wickersham points out, if the creditors have the right to rely upon the par value of issued stock, there would seem to be no basis for a distinction between the original issue and any subsequent issue. It is otherwise if it is an obligation to contribute imposed by law, according to circumstances.⁵⁴

By the Minnesota General Statutes, 1913, sec. 6193, it is provided "that no corporation shall issue any shares of stock for a less amount to be actually paid in than the par value of those first issued." This statutory provision, enacted in 1866, leaves little room for doubt that this market price exception to the obligation of paying the par value could not be followed in Minnesota.

Bonds on the other hand, apart from usury laws, may be sold for less than face value.⁵⁵ Bondholders are not owners but creditors of the enterprise. They do not enjoy the privilege of sharing the profits with limited liability and so do not come under an obligation to contribute a specified amount to the capital. Under

⁵¹Handley v. Stutz, (1891) 139 U.S. 447, 35 L. Ed. 227, 11 S.C.R. 530; Thomas & Brenneman v. Goodman, (1918) 254 Fed. 39, 165 C.C.A. 391; Courtney v. Georger, (1916) 228 Fed. 859, 143 C.C.A. 257; 3 MINNESOTA LAW REVIEW 281; Wickersham, 22 Harv. Law Rev. 319, 331, Trust Fund Theory, Pepper. 32 Am. Law Reg. (N.S.) 175; McMurtrie, 25 Am. L. Rev. 749, Thatcher, 25 Am. Law Review, 940.

⁵²Weed etc., R. Co. v. Gainsville, (1904) 119 Ga. 596, 46 S.E. 895; Iowa Drug Co. v. Souers, (1908), 139 Ia. 72, 117 N.W. 300, 19 L.R.A. (N.S.) 115, See Ann. Cas. 1915A 1271.

⁵³Clark v. Bever, (1891) 139 U.S. 96, 110, 35 L. Ed. 88, 11 S.C.R. 468; Fogg v. Blair, (1891) 139 U.S. 118, 35 L. Ed. 104, 11 S.C.R. 476. See Hospes v. Northwestern Mfg. & Car Co., (1892) 48 Minn. 174, 197, 50 N.W. 1117, 31 A.S.R. 637, 15 L.R.A. 476.

⁵⁴Wallace v. Carpenter Electric Heating Mfg. Co., (1897) 70 Minn. 321, 73 N.W. 189, 68 A.S.R. 530. See 3 MINNESOTA LAW REVIEW 281, Hospes v. Northwestern Mfg. & Car Co., (1892) 48 Minn. 174, 197, 50 N.W. 1117, 31 A.S.R. 637, 51 L.R.A. 470. See also 1 Machen, Corp. 631; 14 C. J. 959. Enright v. Heckscher, (1917) 240 Fed. 863, 153 C.C.A. 549; Donald v. Am. Smelting & Refining Co., (1901) 62 N. J. Eq. 729, 48 Atl. 771, 1116.

⁵⁵Clearwater County State Bank v. Bagley-Ogema Telephone Co., (1911) 116 Minn. 4, 133 N.W. 91, Ann. Cas. 1913A 622; Pueblo Foundry & Machine Co. v. Lannon, (1920) 68 Colo. 131, 187 Pac. 1031.

some statutes, however, bonds are declared void if issued at less than a certain per cent of their face value.⁵⁶

In the last few years twenty-three or more states and the Dominion of Canada have adopted laws authorizing corporations to be formed with stock having no stated par value.⁵⁷ The great popularity of this idea of non-par stock arouses a question whether it possesses more than legitimate attractiveness to those interested in the promotion and organization of corporations. It seems to be provided in all the statutes as to non-par stock that it shall be deemed fully paid and non-assessable. The holder of the shares is not liable to the corporation nor to the creditors on the stock, no matter how little has been paid. This provision renders inapplicable the great mass of law on stockholders' liability on bonus and watered stock. Stock without par value can be issued as fully paid for contracts, patents, mines, or promotion services. This insures promoters and organizers against liability to creditors based on over-valuation of assets. It furnishes a very convenient means of providing liberally for those who have promoted or brought about the organization of the corporation.

Some possible objections to no-par stock which need more careful attention than the present laws give, are: First, the ease of inflation and the danger of manipulation by issuing large amounts of stock for property of little value;⁵⁸ Second, the possibility of frauds on investors by diluting the stock already issued by subsequent issues at lower prices; theoretically the subscription price of the stock should be uniform and equal; at least in the beginning the subscriber should have some assurance that others will not pay less than he is required to pay; Third, the absence of any convenient basis of taxation for organization and franchise taxes;⁵⁹ Fourth, the lack of sufficient protection to creditors, only

⁵⁶In *re* Valecia Condensed Milk Co., (1916) 233 Fed. 173, 147 C.C.A. 183; Thompson, Corp. sec. 2241, 2246.

⁵⁷Ala. (1919); Cal. (1917); Colo. (1921); Del. (1917); Idaho (1921); Ill. (1919); Kan. (1921); Me. (1917); Md. (1916); Mass. (1921); Mich. (1921); Mo. (1921); N.H. (1919); N.J. (1920); N.Y. (1912); N.C. (1921); Okla. (1919); Pa. (1919); R.I. (1919); Utah (1921); Va. (1918); W. Va. (1920); Wis. (1919); Canada, (1917).

The following states have issued licenses to admit foreign corporations having shares without par value to do business in the state. Ark., Colo., Fla., Md., Iowa., Ky., Minn., Mont., Nev., N. Dak., Ore., S. Dak., Tex., Vt.

The right to do business as a foreign corporation has been refused in six states: Ga., Neb., N. Mex., S. Car., Tenn., and Washington. See Rice & Harno, *Non-Par Value Stock*, 56 Am. L. Rev. 329.

⁵⁸Cook, 19 Mich. L. Rev. 583, 592; 7 Am. Bar Assn. 534.

⁵⁹Pierson, *Stock Having No Par Value*, 17 Ill. L. Rev. 173, 184.

a small amount of capital usually being required to be paid in as a basis of financial responsibility at the start, with no provision for increase later.

The principal arguments advanced in favor of no-par stock are:

1. That the par value is misleading to investors. It is supposed that misrepresentation or misunderstanding arises through the difference between the actual value and the par value. Some writers seem to labor under the misapprehension that it is the doctrine of the law that the assets or capital of the corporation shall at all times equal the face value of the stock, and that the par value of the stock is an index to the assets of the corporation.⁶⁰ That, however, is only the case with banks and financial corporations. Shares are supposed to represent membership based on specified sums of money contributed to capital. The par value of issued stock is not supposed to be the index of the financial condition for the information of investors and creditors and is probably not relied upon as such. No doubt inexperienced persons are sometimes misled into subscribing for stock at a discount or taking it as a bonus with no idea of the liabilities thereby incurred.

2. A more substantial argument is that some method should be provided to give an interest in the profits to persons concerned as founders and organizers, regardless of the actual contribution in money or property which they make to the corporation's capital. Capital isn't everything in a corporation any more than in a partnership. At present this can be accomplished only by subterfuge and indirection.

3. It is desirable that a going concern should be able to increase its capital by a new issue of stock, to be sold at the market price, rather than to be compelled to increase its fixed charges by an issue of bonds if the stock has fallen below par. It ought to be possible also to give a bonus of common stock with bonds or preferred stock to add a speculative attraction to the investment.

4. A strong argument in favor of the no-par stock would seem to be that the performance of the obligation to pay the par value of stock is usually fictitious. The courts apply more or less uncertain tests to determine the liability of the stockholder

⁶⁰Rice & Harno, *Shares With No Par Value*, 5 MINNESOTA LAW REVIEW 493, 497; 56 Am. L. Rev. 321, Thompson, *Corporations*, 1922 Supplement, Sec. 3447; Morawetz, 26 Harv. L. Rev. 729.

when the creditors call upon him to pay the difference between the face value of the stock and the value of property transferred. The liability of the stockholder is thus left in doubt and uncertainty. The attempt to enforce proper contributions of capital and to safeguard creditors in this manner is largely a failure and should perhaps be abandoned in favor of something else. The amount of capital which a corporation must have as a basis of financial responsibility may be fixed without reference to the number of shares issued, by an amount to be stated in the charter or articles of incorporation. The present non-par laws, however, seem very inadequate in this regard.

There may be some doubt, in view of the Minnesota constitutional double liability provision that "stockholders in any corporation, excepting those organized for the purpose of carrying on any kind of manufacturing or mechanical business, shall be liable to the *amount of stock* held or owned by them," whether it is possible for the legislature of this state to provide for no-par stock. The difficulty might perhaps be met if the statute should provide that "the amount of the stock" for purposes of stockholder's liability, but for no other purpose, should be taken to be of the par value of \$100 per share." It has recently been held, however, that a statute which places a value of \$100 per share on stock of no par value, for purposes of taxation, is unconstitutional, as arbitrary, discriminatory, and unequal.^{60a}

III. RIGHTS OF CREDITORS AGAINST STOCKHOLDERS BY REASON OF CONSTITUTIONAL OR DOUBLE LIABILITY

Statutes and constitutional provisions have been adopted in some states for the purpose of providing a security for creditors in addition to the security furnished by the company's capital. Statutes providing that stockholders shall be liable to the par value of their stock impose little more liability than would exist in equity. Statutes imposing an additional liability to an amount equal to the par value of the stock, that is a double liability, are now rare except in the case of banks. In California a peculiar statutory liability is imposed for each debt in proportion to the amount or value of the stock held.⁶¹ In some states individual

^{60a}People ex rel. Walsh v. Tax Commissioners, (App. Div. N. Y. 1922) 195 N.Y.S. 184; See also People ex rel. v. Mensching, (1907) 187 N.Y. 8, 79 N.E. 884, 10 L.R.A. (N.S.) 625, 10 Ann. Cas. 101.

⁶¹Sacramento Bank v. Pacific Bank, (1889) 124 Cal. 147, 56 Pac. 787, 71 A.S.R. 36.

liability is imposed upon stockholders until the entire or a specified amount of the capital stock has been paid in; in others there is a liability for particular debts such as those due laborers; by some statutes penal liabilities are imposed for failure to file reports or otherwise comply with the requirements of the corporation laws.⁶²

It is the policy of Minnesota as expressed in our present constitution, that stockholders of corporations should be individually liable to a limited amount and that the measure of such liability should be a sum equal to the par value of the stock owned or held by them. Mr. Justice Miller, of the United States Supreme Court, speaking of the distinction between joint stock companies and corporations, said in 1870:⁶⁴

"The principle of personal liability of the shareholders attaches to a very large proportion of the corporations of this country, and is a principle which has warm advocates for its universal application when the organization is for pecuniary gain."

This is certainly no longer the attitude of those who make the corporation laws of this country. The great advantage of incorporation is the exemption of the stockholder from individual liability, except for the par value of the stock held. When this is once paid there is at common law no further liability. Double or superadded liability by statute is common in case of banks, but as to other classes of corporations it has become exceptional. The policy of American corporation law at the present day is to encourage enterprise, and to favor the interests of the investor as against the creditor.

As Cook says:⁶⁵

"This class of statutes, except in the case of banks, have proved signal failures. They drive corporations from the state, are rarely relied upon by creditors, and are productive of interminable litigation."

Business men may well hesitate to incorporate large or speculative enterprises in Minnesota and incur the risk that the stockholders will be held as guarantors to creditors in case of failure. When the incorporation is applied for in another state no such liability will be incurred. Stockholders of a foreign corporation

⁶²3 Clark & Marshall, Corps. sec. 806; Minn. G.S. 1913. 6178-2; 4 C. J. Corp. p. 980. *Natl. New Haven Bank v. Northwestern Guaranty Loan Co.*, (1895) 61 Minn. 375, 63 N.W. 1079.

⁶³Willis v. Mabon, (1892) 48 Minn. 140, 149, 50 N.W. 1110.

⁶⁴*Liverpool Ins. Co. v. Mass.*, (1870) 10 Wall. (U.S.) 566, 9 L. Ed. 1029; quoted by Lurton J. in *Andrews Bros. Co. v. Youngstown Coke Co.*, (1898) 86 Fed. 585.

⁶⁵Stock and Stockholders, sec. 215.

doing business here escape this double liability altogether, being subject only to such liability as is imposed by the state of incorporation. We thus favor the stranger within our gates and lose the benefit of large incorporation fees, regulatory power and the convenience of domestic incorporation owing to dangerous and unusual liabilities not imposed on stockholders of foreign corporations.

Section 3, article 10 of the Minnesota constitution provides:

"Each stockholder in any corporation, excepting those organized for the purpose of carrying on any kind of manufacturing or mechanical business, shall be liable to the amount of stock held or owned by him."

The effect of this provision is stated as follows by the United States Supreme Court:⁶⁶

"The provision is self-executing, and under it each stockholder becomes liable for the debts of the corporation in an amount measured by the par value of his stock. This liability is not to the corporation but to the creditors collectively, is not penal but contractual, is not joint but several, and the mode and means of its enforcement are subject to legislative regulation."⁶⁷

The constitutional amendment of 1872 excepted the stockholders of manufacturing and mechanical corporations from the personal liability imposed by article 10, section 3, of the constitution upon stockholders of all corporations. The purpose of this amendment, as stated by Justice Mitchell, was to encourage manufacturing enterprises by exempting those investing their capital in that business from personal liability.⁶⁸ It was held that to extend this exemption to corporations combining manufacturing with some other distinct and independent business would defeat the object of the amendment of 1872 and also nullify the constitutional provision imposing liability on the stockholders of all but manufacturing and mechanical corporations.

As is said by Brown, C. J.:⁶⁹

⁶⁶Converse v. Hamilton, (1912) 224 U. S. 243, 253, 255, 56 L. Ed. 749, 32 S.C.R. 415.

⁶⁷Citing: Willis v. Mabon, (1892) 48 Minn. 140, 50 N.W. 1110, 31 A.S.R. 626, 16 L.R.A. 281; Minneapolis Baseball Co. v. City Bank, (1896) 66 Minn. 441, 446, 69 N.W. 331; Hanson v. Davison, (1898) 73 Minn. 454, 76 N.W. 254; Straw & Ellsworth Mfg. Co. v. Kilbourne Boot & Shoe Co., (1900), 80 Minn. 125, 83 N.W. 36; London & North West American Mortgage Co. v. St. Paul Park Improvement Co., (1901) 84 Minn. 144, 86 N.W. 872; Bernheimer v. Converse, (1907) 206 U.S. 516, 51 L. Ed. 1163, 27 S.C.R. 755.

⁶⁸State ex rel. Clapp v. Minnesota Thresher Mfg. Co., (1889) 40 Minn. 213, 222, 41 N.W. 1020, 3 L.R.A. 510.

⁶⁹Graff v. Minnesota Flint Rock Co., (1920) 147 Minn. 58, 179 N.W. 562.

"If the corporation under the authority reserved to it by its articles of incorporation, lawfully may engage in any business or occupation other than manufacturing, not incidental to nor allied therewith, the constitutional exemption from liability does not apply. . . A manufacturer is one who by labor, art, or skill transforms raw material into some kind of a finished product or article of trade."

As stated by Judge Mitchell in another case:⁷⁰

"If the corporation is organized for the purpose, as declared in the articles of association, of carrying on both a manufacturing business and also some other kind of business not properly incidental to or necessarily connected with a manufacturing business, the mere fact that the corporation never exercised all its corporate powers, and never in fact engaged in or carried on anything but a manufacturing business, will not bring the case within the constitutional exception."

A "mechanical business," within the meaning of the constitutional exception, is one incidental to or closely allied with some kind of manufacturing business. It is held that the mining of iron ore is such a mechanical business and the stockholder of a corporation organized for that purpose is exempt from the stockholder's double liability.⁷¹ But a corporation authorized by its articles to speculate in mineral lands, in addition to the power to mine and work ores, is not organized for the purpose of an exclusively mechanical business.⁷²

The fact that a manufacturing corporation engages in a line of business not authorized by the articles of incorporation, does not subject the stockholders to double liability.⁷³ What the situation would be, however, if a corporation were organized for the very purpose of evasion of the law as a manufacturing company, if only a trifling part of the business actually transacted were manufacturing, and the real object of the organization was the carrying on of some other kind of business such as buying and selling, has not been settled as yet by the decisions of this state.⁷⁴

Corporations which "embrace banking privileges" are excepted from the operation of article 10, section 3 of the constitution by article 10, section 1. But it is held that stockholders of a banking

⁷⁰Arthur v. Willius, (1890) 44 Minn. 409, 415, 46 N.W. 851.

⁷¹Cowling v. Zenith Iron Co., (1896) 65 Minn. 263, 68 N.W. 48, 60 A.S.R. 471, 33 L.R.A. 508.

⁷²Anderson v. Anderson, (1896) 65 Minn. 281, 68 N.W. 49; 33 L.R.A. 510.

⁷³Nicollet Nat. Bank v. Frisk Turner Co., (1898) 71 Minn. 413, 74 N.W. 160, 70 A.S.R. 334.

⁷⁴See Mohr v. Minnesota Elevator Co., (1889) 40 Minn. 343, 346, 41 N.W. 1074; Arthur v. Willius, (1890) 44 Minn. 409, 416, 46 N.W. 851.

corporation organized under the laws of this state, which is not a bank of issue or circulation, are liable under article 10, section 3, for the debts of the corporation. The clause, "except such as embrace banking privileges" refers only to banks of issue or circulation whose stockholders are made liable by article 9, section 13.⁷⁵ The constitutional liability, which constitutes a reserve or trust fund for the benefit of creditors, is not discharged by the payment of an assessment upon bank stock levied pursuant to orders given by the public examiner on account of an impairment of the bank's capital, and to enable it to re-open its doors and continue its banking business.⁷⁶

The methods of avoiding stockholders' liability are: First, to organize as a manufacturing or mechanical corporation; Second, to issue only a few shares of low par value and to capitalize the corporation by an issue of bonds secured by mortgage. This will have the advantage of giving the owners priority over general creditors; also the bonds may be deducted from property in a statement of tangible property, or the interest from income, and thus bring about a reduction of taxes.⁷⁷ The third and usual method is to incorporate in another state such as South Dakota, where the taxes are low, and either do business in Minnesota as a foreign corporation or organize a small local operating company with a nominal capitalization as local agent.

The nature of the constitutional liability of stockholders is described in *Northwestern Trust Co. v. Bradbury*⁷⁸ as being "for all practical purposes a reserve or trust fund, to be resorted to only in proceedings for liquidation, when necessary to meet the obligations of the corporation. It is limited to an amount equal to the par value of the stock held and owned by each stockholder, and exists in favor of the creditors collectively, not severally, and in proportion to the amount of their respective claims against the corporation. No single creditor can enforce payment of his debt against any one or more of the stockholders, because he has no several or independent right to the fund."

It follows from this that:

"A stockholder cannot, by the voluntary payment of the full quota of his liability to a particular creditor or set of creditors,

⁷⁵*Northwestern Trust Company v. Bradbury*, (1910) 112 Minn. 76, 127 N.W. 386; *International Trust Company v. American Loan & Trust Company*, (1895) 62 Minn. 501, 65 N.W. 78, 632; *Allen v. Walsh*, (1879) 25 Minn. 543, 541.

⁷⁶*Northwestern Trust Company v. Bradbury*, (1912) 117 Minn. 83, 134 N.W. 513, Ann. Cas. 1913D 69.

⁷⁷*Conyngton, Corp. Procedure sec. 93.*

⁷⁸(1912) 117 Minn. 183, 134 N.W. 513.

discharge his further responsibility. . . a trust fund designed for the benefit of all creditors would be thus unfairly distributed, and those most deserving, perhaps, deprived of the benefit the law intended to confer upon them."

The constitutional liability of stockholders does not depend upon presumed reliance or estoppel but extends to present as well as to future creditors, unlike liability upon watered or bonus stock.⁷⁹ The stockholder is liable as long as he holds his stock, although he may have a right of action to rescind his stock subscription if induced by fraud of the corporation.⁸⁰ It has been held that a renewal of a certificate of deposit by the issue of a new one in lieu thereof, after transfer of bank stock, creates a new debt and relieves the former stockholder from his liability.⁸¹ When a corporation is declared insolvent and goes into the hands of a receiver all corporate debts mature. The stockholders' liability becomes fixed as of that date for whatever deficiencies then exist; the cause of action then accrues so as to set the statute of limitations running.⁸²

Under the laws of California a stockholder of a domestic or foreign corporation is liable for his proportion of the debts of a corporation as a principal and not as a surety. The California constitutional provision makes the liability of the stockholder that proportion of the creditor's total claim which the amount of stock owned by the shareholder at the time the debt was contracted bears to the whole subscribed capital stock.⁸³ The California statute imposes a primary and direct liability to the creditor which can be enforced in an action against the stockholder independent of any judgment against the corporation. The stockholder is liable individually, as a principal debtor, not as a surety or guarantor.⁸⁴

The Minnesota statute on the other hand imposes a secondary liability to contribute to a fund to be distributed by a court of equity among the creditors equally. The stockholders are in the position of sureties or guarantors for the debts of the corpora-

⁷⁹*Olson v. Cook*, (1894) 57 Minn. 552, 561, 59 N.W. 635; *First National Bank v. Winona Plow Co.*, (1894) 58 Minn. 167, 59 N.W. 997.

⁸⁰*Bartlett v. Stephens*, (1917) 137 Minn. 213, 163 N.W. 288.

⁸¹*Seymour v. Bank of Minnesota*, (1900), 79 Minn. 211, 81 N.W. 1059. Compare L.R.A. 1915B 168 n.

⁸²*Shearer v. Christy*, (1917) 136 Minn. 111, 114, 161 N.W. 498.

⁸³*Gardner v. Bank of Napa*, (1911) 160 Cal. 177, 117 Pac. 667.

⁸⁴*Ellsworth v. Bradford*, (1921) 199 Pac. 335.

tion.⁸⁵ The discharge of the corporation in bankruptcy does not extinguish the debt or release the surety from liability.

It seems that the stockholder's constitutional liability is secondary to the liability upon watered or bonus stock. In *Hosford v. Cuyuna Minneapolis Iron Co.*⁸⁶ one contention was that the primary liability of stockholders who paid the corporation nothing or less than par for the stock they had obtained, had not been taken into consideration. It was also contended that all persons who obtained any of the stock without paying for it in full should be compelled to pay for it before the stockholders' liability was enforced. Lees, C., says "there seems to be substantial basis for this assertion," but it was held that the court was justified in assessing the stockholders unless the corporate assets available were clearly sufficient to pay the corporate debts in full and without delay and that the assessment should stand unless palpably beyond all reasonable necessity. It would seem that the statutory liability is the ultimate resource of the creditors, the last resort, and that the assets of the corporation, including the liability of the stockholder to pay for his shares in full, are primarily liable for the corporate debts.⁸⁷

In general where a stockholder makes a complete sale and transfer of his stock, and the transfer is duly registered, a novation or substitution is produced and the transferee is the one liable for future calls for the unpaid balance due on the stock.⁸⁸ The stockholders' liability for unpaid subscriptions does not continue after he has transferred the stock, except when the transfer was made for the purpose of defrauding creditors.⁸⁹ But if the transfer is made without consideration after the company has become insolvent this makes out a prima facie case of fraud upon creditors.⁹⁰

⁸⁵Way v. Barney, (1911) 116 Minn. 285, 133 N.W. 801, Ann. Cas. 1913A 719.

⁸⁶(Minn. 1922) 189 N.W. 1025.

⁸⁷See also Dupont v. Ball, (1918) 11 Del. Ch. 430, 106 Atl. 39, 7 A.L.R. 955; Weil v. Defenback, (1918) 31 Idaho 258, 170 Pac. 103; Peter v. Union Mfg. Co., (1897) 56 Ohio St. 181, 202.

⁸⁸Basting v. Northern Trust Co., (1895) 61 Minn. 307, 311, 63 N.W. 721; 14 C. J. 780. See Axford v. Western Inv. Co., (1918) 141 Minn. 412, 423, 168 N.W. 97, 170 N.W. 587.

⁸⁹In re Peoples Livestock Insurance Co., (1894) 56 Minn. 180, 186, 57 N.W. 468.

⁹⁰McConey v. Belton Oil Gas Co., (1906) 97 Minn. 190, 198, 106 N.W. 900.

A transferee of under-paid stock who doesn't participate in the transaction whereby the stock was issued and who purchases the stock on a representation by the corporation that the stock is fully paid cannot be held liable to creditors of the corporation for the difference between the price paid and the par value of the stock.⁹¹ Whether on the fraud theory a transferee with notice can be held on bonus or underpaid stock to a creditor who became such after the issue of the stock, but prior to the transfer, query?

A shareholder in a corporation cannot escape his constitutional liability for the debts of the corporation even by a bona fide sale of the stock to a solvent party and a transfer on the books of the corporation.⁹² Nor can he escape by selling or surrendering his stock to the corporation.⁹³ After transfer of the stock the liability rests primarily upon the transferee. While the transferor is not released from liability from the then existing debts of the corporation, his liability, thereafter, becomes secondary to that of the transferee, and the liability of both is secondary to that of the corporation. A valid extension of time for payment granted by a creditor to the corporation without the consent of the stockholder who has previously transferred his stock operates to release such stockholder from his liability as surety for the debt, but the burden is upon the stockholder to show that such extension was made without his consent.⁹⁴

IV. METHOD OF ENFORCEMENT.

1. *Statutory or Double Liability.* The statutes give the individual creditor no right of action against the individual stockholder. Since the decision in *Allen v. Walsh*,⁹⁵ the law applicable to the enforcement of the constitutional liability has been settled, that the only remedy is by proceedings brought in behalf of all the creditors and that this, being the remedy prescribed by statute, is exclusive.⁹⁶ The proper form of action in which to enforce the

⁹¹*Rhode v. Dock Hop Co.*, (1920) 184 Cal. 367, 194 Pac. 11, 12 Am. L. R. 437, 449; *Bowen v. Imperial Theaters Inc.*, (Del. Ch. 1922) 115 Atl. 918. See *Warren*, 34 Harv. L. Rev. 287; 9 Cal. L. Rev. 238.

⁹²*Minn. G.S.* 1913, sec. 6177, *Tiffany v. Gieson*, (1905) 96 Minn. 448, 105 N.W. 901; *Gunnison v. U.S. Investment Co.*, (1897) 70 Minn. 292, 73 N.W. 149; *Selig v. Hamilton*, (1914) 234 U.S. 652, 659, 58 L. Ed. 1518, 34 S.C.R. 926, Ann. Cas. 1917A 104.

⁹³*Lebens v. Nelson*, (1921) 148 Minn. 240, 181 N.W. 350; 14A C. J. 280.

⁹⁴*Way v. Mooers*, (1917) 135 Minn. 339, 160 N.W. 1014. See also *Harper v. Carroll*, (1896) 66 Minn. 487, 502, 503, 69 N.W. 610, 1069.

⁹⁵(1879) 25 Minn. 543, 553.

⁹⁶*Northwestern Trust Co. v. Bradbury*, (1912) 117 Minn. 83, 89, 134 N.W. 513; *McKusick v. Seymour*, (1892) 48 Minn. 158, 170, 50 N.W. 1114;

double liability of stockholders is sequestration proceedings under what was formerly chapter 76. Prior to the revision of 1905 the statutes relating to sequestration proceedings and the enforcement of stockholders' liability are found in chapter 76, of the various editions of the statutes.⁹⁷ The plaintiff must be a judgment creditor who has exhausted his legal remedies by having an execution against the corporation returned unsatisfied. The court may in this proceeding sequester the property of the corporation, appoint a receiver, and upon final judgment order the property or its proceeds to be distributed proportionately among the creditors. This is in its nature an equitable action in behalf of all the creditors against the corporation and its stockholders, wherein the debts of the corporation are determined and after exhausting the corporate assets, the liability of the stockholders for any deficiency may be adjudicated and enforced.⁹⁸ In *McKusick v. Seymour, Sabin & Co.*,⁹⁹ it was pointed out that the stockholders may only be compelled to contribute the deficiency, which can only be estimated after the corporate assets are all distributed among the creditors, which has to be done in the sequestration proceeding, if one is pending. Judge Mitchell says:

"It is entirely consistent with the established equity jurisdiction and in accordance with established equity practice, to forestall a multiplicity of actions by bringing all the litigation into its grasp in one suit for a general accounting and a complete adjustment of all rights. . . . In fact it is only by sequestering the corporate assets and enforcing this liability of stockholders in the same proceeding that results equally just and equitable to all parties can be worked out."

Whatever is realized in such a proceeding belongs to all the creditors, or at least to all that class of creditors entitled to participate in the fund, and will be in the custody of the court and distributed by it, or by the receiver under its direction.

Hanson v. Davison, (1898) 73 Minn. 454, 76 N.W. 254; Harper v. Carroll, (1896) 66 Minn. 487, 69 N.W. 610, 1069; Johnson v. Fischer, (1883) 30 Minn. 173, 14 N.W. 799; Mpls. Baseball Co. v. City Bank, (1896) 66 Minn. 441, 69 N.W. 331.

⁹⁷See Minn. R. L. 1905 secs. 3169, 3183, Minn. G.S. 1913 secs. 6634 ff; Dunnell's Digest sec. 2144.

⁹⁸Hanson v. Davison, (1898) 73 Minn. 454, 76 N.W. 254; McKusick v. Seymour, Sabin & Co., (1892) 48 Minn. 158, 50 N.W. 1114; Winnebago Paper Mills Co. v. Northwestern Printing, etc., Co., (1895) 61 Minn. 373, 63 N.W. 1024; Parten v. Southern Col. Co., (1920) 146 Minn. 287, 178 N.W. 744.

⁹⁹(1892) 48 Minn. 158, 50 N.W. 1114.

The enforcement of stockholder's liability for corporate debts in sequestration proceedings is now regulated by a statute enacted in 1899.¹⁰⁰ This statute provides a method for the enforcement of any kind of liability, constitutional, statutory, or otherwise, upon a petition by a receiver or assignee of a corporation or of any creditor thereof whose claim has been filed. The statute provides for due notice by publication or otherwise, for a general inquiry into the question whether the available assets will be sufficient to pay the expenses of the proceedings and the indebtedness in full and without delay, and for a ratable assessment upon all parties liable as stockholders for such amount or percentage of such liability upon each share of stock as it shall deem proper. The order is to authorize and direct the assignee or receiver to collect the amount so assessed and upon failure of payment by any stockholders to prosecute an action against them whether resident or non-resident and wherever found.

Proceedings under sec. 6646, Minn. G. S. 1913 upon petition for an assessment against the stockholders of an insolvent corporation are summary and informal. The statute provides that the court shall consider evidence bearing upon the following points: (1) The nature and probable extent of the indebtedness of the corporation; (2) the probable expense of the receivership; (3) the probable amount of available assets; and (4) the persons liable as stockholders, the nature and extent of their liability, and their probable solvency or responsibility; and therefrom determine the propriety and necessity of the proposed assessment. The question is to be determined by the probability of the case.¹⁰¹ The assessment is but the foundation for the proceedings subsequently to be brought for collection if voluntary payment be not made. If a surplus remains after payment of debts and expenses it is returned to the stockholders.¹⁰²

The proceeding on the petition by the receiver or creditor for an assessment on the stockholders is not an independent suit but is simply a further step in the original sequestration proceedings.¹⁰³ The proceedings have two stages; (1) the taking of an account

¹⁰⁰Laws 1899 C. 272, Minn. R. L. 1905 secs. 3184, 3190, Minn. G.S. 1913, sec. 6645 ff. *Way v. Barney*, (1911) 116 Minn. 285, 294, 133 N.W. 801.

¹⁰¹*Hosford v. Cuyuna Mpls. Iron Co.*, (Minn. 1922) 189 N.W. 1025

¹⁰²See generally *Straw & Ellsworth Co., v. L. D. Kilbourne, etc., Co.*, (1900) 80 Minn. 125, 83 N.W. 36; *Van Slyck v. Vanasek*, (1916) 132 Minn. 9, 155 N.W. 754.

¹⁰³*Ueland v. Hagan*, (1897) 70 Minn. 349, 73 N.W. 169.

and the levying of an assessment upon the stockholders; and (2) the collection of the assessment by individual suits by the receiver.

It is said that the proceeding is not materially different from that authorized by the National Banking Act, except that under the latter the assessment is made by the comptroller of the currency, while here the assessment is made by the court.¹⁰⁴

The order of assessment is, under sec. 6647 G. S. 1913, conclusive upon all of the stockholders as to all matters relating to the amount, propriety, and necessity of the assessment. No person is deprived by the finding however, of opportunity of showing that he is not a stockholder, or that he holds less stock than found, or that he has a set-off available or has any other defence personal to himself.¹⁰⁵ The conclusive effect of the court's order is not dependent on the personal appearance or joinder of the stockholders because they are represented by the corporation.¹⁰⁶ There is no difference between a suit against a stockholder for an unpaid subscription and a claim against him on his superadded liability, so far as the conclusiveness of the assessment is concerned.¹⁰⁷

An ancillary action may be prosecuted in another state, if necessary, by the receiver appointed to collect and distribute the fund arising from the stockholders' liability in the sequestration proceedings.¹⁰⁸ It is the duty of the courts of other states under the full faith and credit clause to give effect to the orders of the Minnesota courts in making assessments on stockholders, although the stockholders were not personally made parties to the suits in which the orders were made.¹⁰⁹

¹⁰⁴*Straw & Ellsworth Co. v. L. D. Kilbourne, etc., Co.*, (1900) 80 Minn. 125, 83 N.W. 36; *Conflict of Laws and Statutory Liability*, Abbot, 23 Harv. L. Rev. 37, 43.

¹⁰⁵*Neff v. Lamm*, (1906) 99 Minn. 115, 108 N.W. 849. *Selig v. Hamilton*, (1914) 234 U.S. 652, 659, 58 L. Ed. 1518, 34 S.C.R. 926; *Hanson v. Davison*, (1898) 73 Minn. 454, 76 N.W. 254; *Harrison v. Carman*, (1921) 149 Minn. 365, 183 N.W. 826; *Abbot*, 23 Harv. L. Rev. 37, 44.

¹⁰⁶*Marin v. Augedahl*, (1918) 247 U.S. 142, 62 L. Ed. 1038, 38 S.C.R. 452.

¹⁰⁷*Hanson v. Davison*, (1898) 73 Minn. 454, 462, 76 N.W. 254.

¹⁰⁸*Hale v. Hardon*, (1899) 95 Fed. 747; *Hanson v. Davison*, (1898) 73 Minn. 454, 76 N.W. 254.

¹⁰⁹*Bernheimer v. Converse*, (1907) 206 U.S. 516, 528, 51 L. Ed. 1163, 27 S.C.R. 755; *Converse v. Hamilton*, (1912) 224 U.S. 243, 56 L. Ed. 749, 32 S.C.R. 415; *Selig v. Hamilton*, (1914) 234 U.S. 652, 58 L. Ed. 1518, 34 S.C.R. 926, *Ann. Cas.* 1917A 104; *Marin v. Augedahl*, (1918) 247 U.S. 142, 62 L. Ed. 1038, 38 S.C.R. 452.

The receiver, as statutory representative of the creditors may sue in aid of the parent proceeding in another state. As is said in *Converse v. Hamilton*.¹¹⁰

"Under this statute, as interpreted by the supreme court of the state, as also by this court, the receiver is not an ordinary chancery receiver or arm of the court appointing him, but a quasi-assignee and representative of the creditors, and when the order levying the assessment is made he becomes invested with the creditors' rights of action against the stockholders and with full authority to enforce the same in any court of competent jurisdiction in the state or elsewhere."¹¹¹

2. *Bonus and Underpaid Stock.* The stockholder's liability on bonus and underpaid stock, like the liability on unpaid subscriptions and like double liability, is in general regarded as a fund for the equal benefit of all the creditors entitled to enforce it. They are, as it were, tenants in common of the amount unpaid on the par value of the stock and the amount still due should be apportioned among them all like a trust fund. Accordingly, the proper remedy for its enforcement would seem to be an equitable proceeding in which all persons interested may be joined and their respective rights, equities, and liabilities adjusted and determined after a proper accounting.¹¹²

Where the liability of stockholders to corporate creditors involves a fund for the benefit of all creditors in proportionate shares, the remedy naturally belongs to a court of equity.¹¹³

It has been held that payment for bonus stock may be enforced in sequestration proceedings just as the constitutional liability is enforced.¹¹⁴ An action to enforce payment for stock issued for an inadequate consideration may be joined with an application

¹¹⁰(1912) 224 U.S. 243, 56 L. Ed. 749, 32 S.C.R. 415.

¹¹¹*Straw & Ellsworth Co. v. L. D. Kilbourne, etc., Co.*, (1900) 80 Minn. 125, 83 N.W. 36; *Bernheimer v. Converse*, (1907) 206 U.S. 516, 51 L. Ed. 1163, 27 S.C.R. 755; *Converse v. Hamilton*, (1912) 224 U.S. 243, 255, 56 L. Ed. 749, 32 S.C.R. 415.

¹¹²*Minnesota Thresher Mfg. Co. v. Langdon*, (1890) 44 Minn. 37, 46 N.W. 310; *Merchants Natl. Bank v. Northwestern Mfg. & Car Co.*, (1891) 48 Minn. 361, 51 N.W. 119; *McKusick v. Seymour, Sabin & Co.*, (1892) 48 Minn. 158, 50 N.W. 1114. See *Pittsburgh Steel Co. v. Baltimore Eq. Soc.*, (1913) 226 U.S. 455, 57 L. Ed. 297, 33 S.C.R. 167.

¹¹³*Hornor v. Henning*, (1876), 93 U.S. 228, 23 L. Ed. 879; *Signor Tie Co. v. Monett, etc. Co.*, (1912) 198 Fed. 412.

¹¹⁴*Hospes v. Northwestern Mfg. & Car Co.*, (1891) 48 Minn. 174, 50 N.W. 1117, Minn. G.S. 1913, sec. 6634. *Hastings Malting Co. v. Iron Range Brewing Co.*, (1896) 65 Minn. 28, 67 N.W. 652; *Merchants Nat. Bank v. Northwestern Mfg. & Car Co.* (1891) 48 Minn. 361, 364, 51 N.W. 119.

for the enforcement of the constitutional liability.¹¹⁵ The liability of the stockholders to pay the par value of the stock held by them may be enforced in the sequestration suit upon the petition or complaint of the receiver or of creditors who have become parties to it. The complaint is, as we have seen, not the commencement of an independent action by creditors in their own behalf, but is filed in the sequestration proceeding itself and in aid of it.

Under sec. 6645 Minn. G. S. 1913, the receiver or assignee of a corporation, as well as any creditor, may petition that the court order an assessment to enforce *any kind of liability* of stockholders to creditors. This provision for the enforcement of the liability of stockholders by a ratable assessment does not supersede the equitable remedy for the enforcement of the liability of holders of bonus or watered stock for the difference between its par value and the amount paid for it. Creditors may enforce such liability by a suit in equity in the federal courts.¹¹⁶ A statutory remedy for the enforcement of liabilities not created by statute is not exclusive.

In the case of *Randall Printing Co. v. Samtas Mineral Water Co.*,¹¹⁷ it is said that an action in the nature of a *creditor's bill* to reach unpaid subscriptions for the benefit of all the creditors may be maintained under R. L. 1905 sec. 3173, Minn., G. S. 1913 sec. 6634 to enforce the liability of resident stockholders in a foreign corporation upon underpaid or bonus stock issued for services to be rendered as directors.¹¹⁸ It is somewhat difficult to see how a "creditors' bill" strictly so called will lie to enforce the liability arising out of the legal fraud which results from the issue of bonus or watered stock. If the present theory is sound that such liability is not an asset of the corporation but is a direct tort liability to the creditor, it would seem rather to be in the nature of a tort action. A judgment creditor's bill is in its essence an equitable action comparable to proceedings supplementary to execution.¹¹⁹ The stockholder's duty to pay par for his stock is indeed essentially capital of the corporation and that is why it is to be equitably enforced for the benefit of all creditors and not by a race of diligence between creditors.¹²⁰

¹¹⁵*Northwestern Railroader v. Prior*, (1897) 68 Minn. 95, 70 N. W. 869, *Fish v. Chase*, (1911) 114 Minn. 460, 131 N.W. 631.

¹¹⁶*Second National Bank of Erie v. Georger*, (1916) 246 Fed. 517.

¹¹⁷(1913) 120 Minn. 268, 139 N.W. 606.

¹¹⁸See also *McConey v. Belton*, (1906) 97 Minn. 190, 106 N.W. 900; assessment not proper as preliminary. *Dispatch Printing Company v. Security Bond, etc., Co.*, (Minn. Jan. 12, 1923.)

¹¹⁹*Pierce v. United States*, (1921) 255 U.S. 398, 402, 65 L. Ed. 404.

Indebtedness of stockholders upon subscriptions to stock is a debt to the corporation itself, not to the creditors. Upon appointment of a receiver of an insolvent corporation, the right to recover unpaid subscriptions, or capital withdrawn and refunded to stockholders passes to the receiver as part of the assets of the corporation.¹²¹ The liability upon bonus and underpaid stock, however, according to the fraud theory, is not and never was an asset of the corporation, for it is due directly to the creditors, and the receiver could not enforce it in the absence of statute.¹²² Yet it is held that when a corporation is insolvent and in the hands of a receiver, the right to enforce liability for bonus stock, like the liability to return funds withdrawn from capital on subscriptions unpaid, cannot be asserted by an individual creditor in proceedings independent of the receivership. The duty to pay the par value is regarded as a potential part of the capital.¹²³ As in the case of double liability stockholders can only be compelled to contribute to the deficiency ascertained after the corporate assets are distributed among the creditors, which has to be done in the sequestration proceeding, if one is pending.¹²⁴

Under the Minnesota doctrine that the stockholders liability for bonus stock is based upon fraudulent representations and that only subsequent creditors who rely upon the representation can recover, the trustee in bankruptcy of the corporation, as successor to the property of the bankrupt, is not the proper person to sue the stockholders. The liability is not an asset of the corporation and does not pass to the trustee, and the bankruptcy act does not give the trustee the right to sue as a representative of the creditors.¹²⁵

As pointed out by Justice Dibell in the *Kenney Case*¹²⁶ the result is unfortunate as the bankruptcy court ought to be able to wind up the whole matter. As Justice Dibell says:

¹²⁰See *Pittsburgh Steel Co. v. Baltimore Equitable Society*, (1913) 226 U.S. 455, 57 L. Ed. 297, 33 S.C.R. 167.

¹²¹*Minnesota Thresher Mfg. Co. v. Langdon*, (1890) 44 Minn. 37, 46 N.W. 310.

¹²²See Tardy's *Smith on Receivers*, 2nd. ed., sec. 357.

¹²³*Merchants Nat. Bank v. Northwestern Mfg. & Car. Co.*, (1891) 48 Minn. 361, 51 N.W. 119.

¹²⁴*McKusick v. Seymour & Co.*, (1891) 48 Minn. 158, 50 N.W. 1114.

¹²⁵*State Bank of Commerce v. Kenney Band Instrument Co.*, (1919) 143 Minn. 236, 173 N.W. 560; *Selig v. Hamilton*, (1914) 234 N.S. 652, 58 L. Ed. 1518, 34 S.C.R. 926, Ann. Cas. 1917A 104; *Courtney v. Croxton*, (1917) 152 C.C.A. 235, 239 Fed. 247; *Courtney v. Georger*, (1916) 143 C.C.A. 257, 228 Fed. 859.

¹²⁶(1919) 143 Minn. 236, 173 N.W. 560.

"A holding which would permit the bankruptcy court in its administration of the bankrupt estate to enforce through its trustee the liability of holders of bonus stock, or to decline to do so and leave it to the state courts, as the convenience of the particular estate suggests, or which would permit the state court to proceed upon the refusal or failure of the trustee or the bankruptcy court to take action, would be workable. This would leave the right of administration in the bankruptcy court with the right in the creditors to prosecute the stock liability if the trustee would not. It might be well if the trustee had the requisite authority and the question were made one of convenient practice."¹²⁷

By Minn. G. S. 1913 sec. 6178 it is declared that each stockholder shall be personally liable for corporate debts in the following cases:

"1. For all unpaid installments on stock owned by him or transferred for the purpose of defrauding creditors." It is held in *Merchant's Nat. Bank v. Bailey Mfg. Co.*,¹²⁸ that an action may be maintained under this section by a single creditor against a solvent corporation and one or more of its stockholders, somewhat in the nature of a garnishment to enforce payment of unpaid installments due on stock for his own benefit. Probably an action would not lie under this section to enforce liability on watered or bonus stock. The double or constitutional liability of stockholders cannot be enforced under this statute.¹²⁹

CONCLUSION

A study of our corporation laws simply with reference to stockholders' liability to creditors and the remedies for its enforcement is sufficient to show that these laws are in a condition calling for prompt and systematic revision. They neither afford adequate protection to creditors nor suitable facilities to capitalists and organizers wishing to promote business enterprises.

It is possible, under our present law, to have a corporation without stockholders or capital stock, which is a legal monstrosity. It is possible to have a corporation with only two or three shares issued, the capital of which is raised by bonds, so that the real

¹²⁷See *Grand Rapids Trust Co. v. Nichols*, (1917) 199 Mich. 126, 165 N.W. 667; *Stacker v. Davidson*, (1906) 74 Kan. 214, 86 Pac. 136; *In re Crystal Springs Bottling Co.*, (1899) 96 Fed. 945; *Bergin v. Blackwood*, (1919) 141 Minn. 325, 170 N.W. 508.

¹²⁸(1885) 34 Minn. 323.

¹²⁹*Winnebago Paper Mills v. Northwestern Printing Co.*, (1895) 61 Minn. 543, 553, 63 N.W. 1024.

proprietors do business under the shield of a mortgage lien, with virtual immunity from the claims of creditors, a gross perversion of corporate mechanism.

The method adopted of enforcing contributions of capital to the corporate being which the law permits the incorporators to spawn upon the business world is ineffectual and leads to systematic evasion. Its enforcement is based upon an artificial theory of fictitious fraud, which operates in favor of one class of creditors who have no better claim to insist on these contributions to the enterprise than another class of creditors. This does not mean that we ought to give up all attempt to enforce proper contributions of capital or to regulate inflation of stock.

Our constitutional double liability is contrary to the public interest and out of date except as to banks and financial corporations. It results in substantial public inconvenience and loss; it is a sword hanging over the head of unsuspecting investors; it discriminates unfairly against Minnesota corporations in favor of foreign corporations, and deprives the state of a large and legitimate source of income from corporation fees and taxes because new enterprises are forced to seek incorporation in other states. Non-par stock laws, such as are being enacted in many other states cannot safely be enacted in Minnesota without a constitutional amendment.¹³⁰ In short it is evident that we have here a subject of great practical importance to the business and prosperity of the state, which demands comprehensive study by scientific legislative draftsmen. Acts should be devised promptly to require the subscription and payment of a minimum capital stock as a condition precedent to the right to begin business; and to limit the issue of mortgage bonds to some proportion of the amount of stock issued, so that incorporators may not be allowed to place the owners of the business in the position of preferred creditors for the capital contributed. Those who are given the hope of unlimited profits should surely take a reasonable degree of risk as the price of limited liability.

¹³⁰Four amendments to article 10, sec. 3, have been submitted to the voters without success. Minn. Laws, 1870 ch. 21; Minn. Laws, 1875 ch. 4; Minn. Laws, 1876 ch. 2; Minn. Laws, 1877 ch. 4; Anderson, *History of the constitution of Minnesota* 196, 197, 249.