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Trust Fund Doctrine Revisited, Part II

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TRUST-FUND DOCTRINE REVISITED
PART II*

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AT AN EARLY DAY the "trust-fund" courts pushed their doctrine far beyond the rules of preferential transfers. Actions by creditors to enforce unpaid stock subscriptions and to recover assets wrongfully distributed to shareholders were soon brought within the scope of this growing theory, despite strong criticism that these actions should never have been stamped with the "trust-fund" label.[67] From its inception the Washington court treated the duty of a shareholder to pay his subscription as an asset belonging to the "trust fund,"[68] and soon thereafter rights of creditors to recover unlawful dividends were swept up in the same judicial tide.[69] This expanded content of the trust fund was said in *Gaunce v. Schoder*[70] to encompass "property in the possession of the corporation, accounts receivable, choses in action, claims of various kinds, as well as unpaid stock subscriptions, payments made to creditors in preference of the rights of other creditors, statutory claims against officers and trustees and rights against stockholders for dividends paid out of capital."[71] This quotation shows that the doctrine has penetrated a larger area of the law of corporations than permits of coverage here. Thus the recovery by creditors of corporate assets distributed to shareholders, while linked to the trust-fund theory in Washington, is a topic requiring separate treatment.

We have chosen the problem of recovery of unpaid subscriptions to illustrate the influence of the trust fund doctrine in our jurisdiction upon actions by creditors against shareholders.

UNPAID STOCK SUBSCRIPTIONS THE RATIONALE OF RECOVERY

Sawyer v. Hoag[72] established that the stockholders of an insolvent corporation were liable to its creditors to the extent of the amount unpaid on stock subscriptions. Justice Miller based liability squarely

* Part I of this article appeared in 24 WASH. L. REV. 44.

ADDENDA TO PART I The writers wish to point out that the statement appearing in 24 WASH. L. REV. at page 49 to the effect that appointment of a receiver would follow "as a matter of course," should not be taken to indicate that the court is without discretion in the matter. REM. REV. STAT. § 9741 states that a receiver may be appointed by the court upon a showing of insolvency "when the court in its sound discretion deems that the appointment of a receiver is necessary to secure ample justice to the parties."

[67] 5 POMEROY, EQUITY JURISPRUDENCE (4th) §§ 2319-2331.

[68] Burch v. Taylor, 1 Wash. 245, 24 Pac. 438 (1890).

[69] Mitchell v. Jordan, 36 Wash. 645, 79 Pac. 311 (1905).

[70] 145 Wash. 604, 261 Pac. 393 (1927).

[71] *Id.* at 605.

[72] 17 Wall. 610, 21 L. Ed. 731 (1873).

on the trust-fund doctrine, saying that the doctrine applied to the capital stock of a corporation "especially its unpaid subscriptions."[73] This holding carved a significant exception out of the general rule that stockholders of a corporation are insulated from liability for its debts.

As long as a corporation remains solvent the subscriber's only liability runs to the corporation.[74] Once the corporation has matured the contract liability of the shareholder, it can, of course, assign that debt like any other. But except by way of assignment, the *creditor* of a *solvent* corporation, being in no sense a party to the subscription contract, is unable to reach an unpaid subscription. Practically speaking, however, as long as the corporation is solvent a corporate creditor will not need to pursue any remedy beyond a direct action against the corporation taken to judgment; hence any absence of privity between creditor and shareholder is not at this time a serious problem. But when the corporation becomes insolvent judgments at law are relatively worthless. At this juncture the trust-fund doctrine entered the picture to protect the creditor.

The statutes of the territory of Washington early provided that every stockholder "shall be personally liable to the creditors of the company to the amount of what remains unpaid upon subscription."[75] This provision was re-enacted in subsequent years with no significant change,[76] and was incorporated in the state constitution.[77] Against the background of the times it is easy to see how the judicial implementation of these provisions would follow trust-fund channels. Thus Judge Dunbar in the early case of *Adamant Manufacturing Co. v. Wallace*[78] quoted the then current text, Morawetz, *On Private Corporations*, as follows:

> The liability of the shareholders to contribute their shares as capital is treated in equity as assets, like other legal claims belonging to the corporation. This liability, together with the capital actually contributed, constitutes the trust fund which in equity is deemed pledged for the payment of the corporate debts.[79]

[73] *Id.* at 620.

[74] 13 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 6056, BALLANTINE CORPORATIONS (Rev. Ed.) § 340; Under REM. REV. STAT. § 3803-22 the corporation is given a lien on shares to the amount of the unpaid subscription and sale is authorized.

[75] CODE PROC. 1881 § 2434.

[76] REM. REV. STAT. § 3824.

[77] WASH. CONST. Art. XII § 4 states, "Each stockholder shall be liable for the debts of the corporation to the amount of his unpaid stock and no more. "

[78] 16 Wash. 614, 48 Pac. 415 (1897).

[79] *Id.* at 618 quoting 2 MORAWETZ, PRIVATE CORPORATIONS § 820.

In the same vein our first state court in *Burch v. Taylor*[80] had previously held that a corporate creditor could not maintain an action *at law* for an unpaid subscription against a stockholder even though our statute made shareholders "personally liable to the creditors." The court reasoned that since stock subscriptions were part of the trust fund for the payment of creditors "to enforce a right to participate in a trust fund requires proceedings in equity."[81] In *Montessano v. Carr*[82] the court went further to hold that a petition by a creditor for money judgment at law against a delinquent subscriber would not support a granting of equitable relief even under the code. "We think the real nature of the action is that of a creditor's bill where the creditor prosecutes for himself and all other creditors, in view of the fact that he is seeking payment of his claim from a trust fund against which his rights are not preferred, but the same as other creditors."[83]

One argument advanced in support of equitable jurisdiction was the prevention of multiple suits by the several creditors against each of the delinquent subscribers, but the idea of equality was again the real moving force: "To allow a single creditor to maintain an action at law against one or more shareholders for his own benefit would be unjust to other creditors."[84] With the tenor of approach set firmly in equity, the statutory provision in effect became merely a reaffirmation of common law liability under the trust-fund doctrine.

Once the cause of action under our statute was construed to be an action under the trust-fund doctrine various refinements of that doctrine began to appear in the cases. The court soon had to define the place of unpaid subscriptions in the trust fund and determine at what time the trust arose. "The capital stock of the corporation constitutes the trust fund," said the court in *Hosner v. Conservative Casualty Co.*[85] Under the general American rule and the statutes of most states this does not mean the capital stock as stated in the articles of incorporation, but rather the capital stock as actually created by the subscription contracts.[86] In answer to the argument that the part of the subscription price over and above par value did not constitute capital

[80] Note 68 *supra*.
[81] Burch v. Taylor, note 68 *supra* at 248.
[82] 80 Wash. 384, 141 Pac. 894, 7 A. L. R. 95 (1914).
[83] *Id.* at 390, citing New York National Exchange Bank v. Metropolitan Savings Bank, 28 Wash. 553, 68 Pac. 905 (1902), Chilberg v. Siebebaum, 41 Wash. 663, 84 Pac. 598 (1906).
[84] Wilson v. Book, 13 Wash. 676, 679, 43 Pac. 939 (1896).
[85] 99 Wash. 161, 164, 168 Pac. 1122 (1917).
[86] 18 C. J. S. 1309.

stock for trust-fund purposes our court held in *Johns v. Clother*[87] that where a subscription price was $150 per share and par value of the shares was only $100 the shareholder would be liable to creditors for the full $150. The court states that the constitutional limitation of the stockholder's liability to "the amount of his unpaid stock and no more" was only a limitation upon the *implied* legal undertaking to pay for the capital stock at par regardless of contract, and was not a limitation upon the power of a stockholder to contract with the corporation to pay more and build up a surplus fund upon which creditors could presumably rely Thus our early statute was sustained in its direction that the amount named in the subscription determine the extent of liability rather than the amount of that subscription attributed to capital stock. In 1933 the Uniform Business Corporations Act re-enacted this rule in even more unequivocal language.[88] In the absence of watering, the amount named in a subscription promise payable in money has invariably been held to be an absolute ceiling on the liability of subscribers in private corporations.[89]

We have seen that the application of the trust-fund doctrine to preferences was limited in time to the period after a corporation became insolvent. Preferential transfers made before insolvency were beyond the pale of creditor challenge. Not so, however, with the liability of the shareholder for his unpaid subscriptions. While insolvency of the corporation is a condition precedent to a creditor's suit in equity to collect the subscription, once this condition is satisfied the creditor or receiver will be able to attack agreements between the corporation and the subscriber made even while the corporation was solvent. Thus in *Johns v. Clother*[90] the creditor was successful even though the corporation while solvent had estopped itself from collecting the full subscription by agreeing that half the price need never be paid. The rights of receiver in such a case may well rise above the corporation's right to sue on the contract, indicating that even before insolvency the subscribed capital "so far has that inchoate character as to prevent it from being surrendered or given away by the corporation. "[91]

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[87] 78 Wash. 602, 139 Pac. 755 (1914).

[88] Rem. Rev. Stat. § 3803-20(2).

[89] See as to liability of stockholders in banking or insurance corporations or joint stock associations, Wash. Const. Art. XII § 11 and Rem. Rev. Stat. § 3242 [P P C. § 309-43].

[90] Note 87 *supra*.

[91] Thoms and Brenneman v. Goodman, 254 Fed. 39, 41 (C. C. A. 6th 1918).

The trust-fund doctrine is not the sole rationale for the recovery of unpaid subscriptions. A theory which often creeps into our court's treatment of of creditors' actions against shareholders has been termed the "reliance" or "fraud" theory In essence this theory states that the shareholders and the corporation have combined to hold the company out as having a certain amount of capital stock; that in reliance on this represented fund creditors are presumed to have extended credit and that therefore the creditor should be able to recover from the shareholder according to the tenor of the representation. An illustration of this approach is contained in the *Clother* case where the court extended the reliance idea to cover surplus as well as capital stock saying "the contract of subscription to the surplus fund was intended, on its face, to create an additional asset upon which creditors might rely, and to which they might resort."[92]

A necessary corollary of this rule would seem to be proof that the extension of credit had been made while this apparent resource appeared on the company books. This is the general rule in jurisdictions following the "fraud" theory[93] In the Washington case of *Murphy v. Panton*[94] the creditors were wholesalers who had furnished goods *after* a purported *cancellation* of a subscription agreement. They were held to be "existing creditors within the meaning of the term as it is employed in cases of this kind";[95] however, the court relied strongly on the existence of a course of dealing extending before the time of cancellation.

Watered stock distinguished. In a large number of suits brought by creditors the subscriber has actually paid for his stock but with property worth less than the par value of his shares. The majority of American courts treat efforts by creditors to recover in these "watered stock" situations under the "fraud" theory[96] It is important to distinguish at this point between the subscriber who is bound by contract

[92] Johns v. Clother, note 87 *supra* at 611. This liability to pay more than par if subscription so states has been generally upheld. 13 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 6064.

[93] However, most courts have not followed the "fraud" theory in suits purely upon subscriptions which have not been paid up to the satisfaction of the corporation. The "fraud" theory is generally applied to actions where the corporation has accepted less than full value as payment. Where the action is upon a genuine "unpaid" subscription the trust fund theory has been the general American rule and under this theory creditors who extended credit before or after the shareholder subscribed are equally able to recover. 13 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 6119. BALLANTINE, CORPORATIONS § 783.

[94] 96 Wash. 637, 165 Pac. 1074 (1917).

[95] *Id.* at 643.

[96] 11 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 5232.

to the corporation to pay a definite amount of money when certain conditions occur and the subscriber who has purported to pay the amount due by transferring property which is overvalued, or has paid cash less than the subscription price under an agreement with the corporation. The former case is one of pure contract liability to the corporation and constitutes the true action for an unpaid subscription.

In the watered stock cases the creditors' action sounds primarily in tort. There the shareholder has satisfied his liability to the company and since there is no obligation running to the corporation there is nothing tangible to place in a corporate trust fund for creditors. The courts have found "fraud" to be the basis of recovery in such cases whether statute so provided or not. Our court while sometimes using trust-fund language has generally applied rules of fraud to these cases. Under these rules only creditors who dealt with the corporation after issue of the fictitiously paid stock and upon the faith of its being properly paid up can recover.[97] Thus in *Sequin v. Plano*[98] credit was extended to a coal mining company whose stock, issued as fully paid, had not, in fact, been paid up. The creditor knew at the time that the undertaking was purely speculative and the court denied him recovery Again in *Johnsen v. The Pheasant Pickling Co.*[99] the court held that in actions to recover upon stock subscriptions paid for in overvalued property it must be shown that the creditor had no knowledge of the overvaluation. The burden of proof on this point was placed upon the creditor.[100] This despite the prior holding in the *Clother*[101] case that the burden of showing the creditor had not relied upon the surplus fund created by the subscriptions rested upon the shareholder. The *Clother* case did not involve the problems of property valuation, but if the court has intended to distinguish its requirements as to burden of proof on that ground, no indication of this appears in either opinion.[102]

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[97] Inland Nursery and Floral Co. v. Rice, 57 Wash. 67, 106 Pac. 499 (1910), Beddow v. Huston, 65 Wash. 585, 118 Pac. 782 (1911), Chamberlain v. Piercy, 82 Wash. 157, 143 Pac. 977 (1914), Colville Valley Coal Co. v. Rogers, 123 Wash. 360, 212 Pac. 732 (1923), Johnsen v. Pheasant Pickling Co., 174 Wash. 236, 24 P (2d) 628 (1933), *cf.* Snyder v. Yakima Finance Corp., 174 Wash. 499, 25 P (2d) 108 (1933).

[98] 160 Wash. 421, 295 Pac. 179 (1931).

[99] 174 Wash. 236, 24 P (2d) 628 (1933), Guaranty Trust Co. v. Satterwhite, 2 Wn.(2d) 252, 97 P.(2d) 1055 (1940).

[100] This accords with the general rule. 4 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 1713.

[101] Note 87 *supra.*

[102] The *Clother* case involved an insurance company and the holding as to burden may have been explained on the close resemblance to banking institutions. The normal rule as to banks places the burden on the subscriber. BALLANTINE, CORPORATIONS (Rev. Ed.) § 342.

Where stock has been issued by a corporation the shareholder can, of course, take advantage of the presumption that all issued stock has been fully paid for. But once the creditor has proved that the stock was not, in fact, fully paid for, should he further be required to prove that he actually gave credit believing that payment in full had been made? Under trust-fund rationale he would be excused from such proof, whereas under the "fraud" theory, advanced by our court in the watered stock cases, he must bear this further burden.

Many courts hold that a creditor's state of mind is wholly immaterial to recovery[103] As a practical matter creditors of going concerns seldom extend credit on the faith of a capital stock item on a balance sheet. The ordinary unsecured creditor would be more interested in the ratio of current assets to current liabilities if he did peruse the balance sheet. In all probability, however, he has never seen the books and his credit was extended upon the general reputation of the company as a credit risk. In the face of these facts a simple, pragmatic rule aimed at protecting creditors regardless of their knowledge of the corporate stock structure, has distinct advantages over a rule based on a fictitious reliance and then purporting to distinguish cases on a presence or absence of this reliance. Such a rule would be more in harmony with the facts of business life and would reduce accounting complications during receivership.

In true actions for unpaid subscriptions the shareholder has paid nothing or made a partial payment on account. His liability runs to the corporation and is solely based on the subscription contract. Since the contract is between the subscriber and the corporation, creditors would not normally be in privity If the corporation has matured the contract liability by a call or assessment then it has on hand an assignable liquid debt and the receiver or creditors acting as equitable assignees can collect whatever remains unpaid. But if the corporation has made no call and refuses to do so there is no matured debt. The terms of the contract do not expressly contemplate a maturing of the subscriber's obligation at the call of strangers, unless the statutory or common law rights of creditors upon insolvency are read into the contract. Our court early held that failure of the directors to make a call before appointment of a receiver would not defeat a creditor's suit after the corporation became insolvent.[104] The obligation of each sub-

[103] BALLANTINE, CORPORATIONS (Rev. Ed.) § 351 and cases listed n. 29; 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (Rev. Ed.) § 608.

[104] McKay v. Elwood, 12 Wash. 579, 41 Pac. 919 (1895), Adamant Manufacturing Co. v. Wallace, 16 Wash. 614, 48 Pac. 415 (1897).

scriber was upon insolvency treated as a debt presently due and the court order as equivalent to the director's call. This is the rule in most states.[105] Some courts reason along "equitable garnishment" lines that the receiver stands in the corporation's shoes for purposes of making the call, corporate performance of this condition in the subscriber's contract being accomplished through the receiver. The creditor's bill proceeding is treated as substantially equivalent to receivership.[106]

The critical hinge in any line of reasoning here is the granting of a right to mature and enforce the subscription contract to creditor or receiver. There is normally no volitional act on the part of the corporation equivalent to assignment in fact, for the creditors are the real actors. Any assignment rationale has an element of fiction in it. In fact, the right of the creditor to sue on this contract is raised by operation of law from the relationship of the subscriber to the corporate debtor and the eixstence of insolvency Once his right to sue be granted the creditor's action sounds essentially in contract. Any explanation of the creditor's right to sue as rising other than by operation of law necessarily relies upon fiction. In essence the shareholder's obligation is rooted in his contract, but the creditor's right to reach that obligation stems from a special rule of law That rule in this jurisdiction has been the trust-fund doctrine or its statutory counterpart.

As this discussion indicates our judges have not followed one simon-pure rationale in dealing with all suits against subscribers. The cases contain "trust fund," "reliance," and "contract" ideas. The few recent Washington cases facing the general problem have not mentioned the words "trust fund,"[107] but if there be an aversion to such terminology there has been little change in the fundamental rules applied. The sloughing-off of old names is not too difficult in this area where the basic tenets of the holdings have been justifiable on general equity grounds and not absolutely dependent on the finding of either express or constructive trust. The critics in this area of the doctrine have been chiefly irked with the use of trust rationale and have not quarreled greatly with the case results.

WAYS AND MEANS OF RECOVERY

We have seen that the corporate creditor seeking to recover from a subscriber the amount of his unpaid subscription after the corpora-

[105] 13 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 6089.
[106] Spencer v. Anderson, 193 Cal. 1, 222 Pac. 355, 35 A. L. R. 822 (1924).
[107] In Johnsen v. Pheasant Pickling Co., note 97 *supra*, the court talked as if the liability was purely statutory. In Guaranty Trust Co. v. Satterwhite, note 99 *supra*, the court talked in terms of contract liability only.

tion has become insolvent must bring his action in equity He may petition the court for the appointment of a receiver or in the alternative may maintain a creditor's bill for the benefit of all the company creditors. In either event our court requires a certain procedure for the protection of the shareholders. A solvent corporation may proceed against some subscribers and not against others, and it is no defense to such actions that there has not been a marshalling of assets or that all the delinquent shareholders have not been proceeded against.[108] However, when the corporation becomes insolvent, a different rule applies and it was held in *Beddow v. Huston*[109] that all delinquent shareholders must be given notice and an opportunity to be heard and that there must be an effort to collect a prorata share of the creditor's claims from all the delinquents. The action is in two cohesive phases. In the first the receiver petitions the court to assess the subscribers and to authorize suit against them. In this action notice and opportunity to be heard must be given to all the subscribers and the receiver must satisfy the court that there are creditors' claims which can only be met by collecting the unpaid subscriptions. The court order then made is an assessment maturing the obligation of the subscriber to pay and a direction that the receiver sue the stockholders on their obligations. It is conclusive as to the necessity of assessment but only establishes *prima facie* the personal liability of the shareholders on their subscriptions. The second phase consists in suits against the subscribers under the assessment. Our court held in *Johnsen v. The Pheasant Pickling Co.*[110] that these dual actions must initially be brought against all the delinquent shareholders and not against any single one. Further the suit must be "for such an amount, as together with the admitted assets would be sufficient to meet the liabilities of the company"[111] The process of collecting only a part of the unpaid subscription is not the universal rule[112] and may be open to serious question on principle. The paid up shareholders of the company have at least a secondary interest in an insolvent corporation. Fairness would seem to dictate that all delinquent subscribers pay their full subscriptions and that any surplus over creditors' claims be ratably distributed among the shareholders. The equity court having taken

[108] Gaunce v. Schoder, 145 Wash. 603, 261 Pac. 393 (1927).

[109] 65 Wash. 585, 118 Pac. 752 (1911), Johnsen v. Pheasant Pickling Co., 174 Wash. 236, 24 P.(2d) 628 (1933), Guaranty Trust Co. v. Satterwhite, 2 Wn.(2d) 252, 97 P.(2d) 1055 (1940).

[110] Note 97 *supra* at 243.

[111] *Id.*

[112] BALLANTINE, CORPORATIONS (Rev. Ed.) § 340.

over the assets of the insolvent, could easily effectuate this more complete collection and disbursement through the medium of the receiver. Again this would simplify the work of the receiver, for he could dispense with the difficult problem of determining the amount of each shareholder's prorata liability, a calculation only capable of approximate correctness in view of the variable collectibility of any judgments he might get.

SHAREHOLDER'S DEFENSES

A wide variety of defenses may be urged by subscribers who are under fire from corporate creditors. However, in general the subscriber has fewer arguments available against creditors than he could have used against the corporation. These defenses are treated in thorough style by Fletcher in his work on corporations,[113] and no attempt is here made to cover so broad a field. We undertake to point out only a few of those defenses which the Washington court has encountered, and to show the variety of results that can be expected under differing rationales.

Statute of limitations. The normal contracts statutes of limitation have been held to apply to actions to enforce a stockholder's liability on his subscription in Washington.[114] In *Guaranty Trust Co. v. Satter-White,*[115] after noting that the two year period for statutory causes had been declared applicable in *Johnsen v. The Pheasant Pickling Co.,*[116] the court expressly chose to adopt the contracts period of limitation, relying on the earlier case of *Guaranty Trust Co. v. Scoon.*[117] This placed Washington in line with the majority rule.[118] The period of limitations has been consistently held to run from the date of the court assessment.[119] In this connection it is important to distinguish between stock subscriptions which have been called in, either automatically or by act of the directors, and stock subscriptions which have never been called before the date of court assessment. If a call has been made the statute begins to run from that time against both the corporation and its creditors. However, where there has been no call by the corporation, and this is the situation we have been generally assuming, the period of limitations does not begin to run until the court makes its assessment.

[113] 4 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 1610 *et. seq.*
[114] Guaranty Trust Co. v. Scoon, 144 Wash. 33, 256 Pac. 74 (1927).
[115] 2 Wn.(2d) 252, 97 P.(2d) 1055 (1940).
[116] Note 97 *supra.*
[117] Note 114 *supra.*
[118] 4 FLETCHER, CYCLOPEDIA OF PRIVATE CORPORATIONS (Perm. Ed.) § 1932.
[119] *Id.* § 1933.

Thus, in Washington the six-year statute will govern in the case of written stock subscriptions. The theoretical basis for holding the cause of action to be contractual has been previously covered.

Rescission of subscription agreement. A subscriber may rescind his subscription agreement with a solvent corporation substantially as he may rescind any contract.[120] Some courts have held, however, that once the corporation has become insolvent a subscription to capital stock can not be rescinded, on the theory that at the moment the corporation becomes insolvent all the assets at once become a trust fund for the creditors.[121] The Washington court, however, pointed out in *Atwood v. McKenzie-Waterhouse Co.*,[122] that such reasoning "loses sight of the fact that the trust fund doctrine is itself based on equitable principles, and that it should yield to equities which are superior." The great weight of American authority holds that a subscriber may rescind even after insolvency under certain conditions.[123] Our court has stated that a stockholder may interpose the defense of fraud even after insolvency, except as to creditors whose claims accrued subsequent to his becoming a stockholder. Thus where the creditor's debt was in existence at the time of the subscription, the subscriber may rescind for fraud. Since many subscriptions are made in the early stages of corporate development and will pre-exist most credit extensions, the Washington rule allows rescission after insolvency to a very limited group of subscribers. This approach is closely related to our court's use of the "reliance" theory The *Atwood* case is settled law but strong argument against it may be made. There should be no magic in the status of *subsequent* creditor. In absence of laches in repudiating the contract properly the question is whether defrauded subscribers should be made subordinate to corporate creditors after insolvency In England they clearly are. The question has been hedged by most American courts along the lines of the *Atwood* case.

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120 REM. REV. STAT. § 3803-6(2).

121 BALLANTINE, CORPORATIONS (Rev. Ed.) § 342.

122 120 Wash. 214, 206 Pac. 978, 41 A. L. R. 650 (1922). At page 218 the court states the rule "he who has been induced by fraudulent representations to subscribe for capital stock of a corporation may rescind after the corporation has become insolvent and has been placed in the hands of a receiver, if he has not been guilty of any laches in discovering the fraud practiced upon him and in repudiating the transaction after discovering the fraud, and has not in the meantime participated in the affairs and business of the corporation, and has not been guilty of any affirmative act which might mislead others to their detriment, and no person has become a creditor of the corporation after his subscription was made." In Chandler v. Miller, 172 Wash. 252, 19 P.(2d) 1108 (1933) the rule of the *Atwood* case was approved but held not applicable to suits to enforce superadded liability imposed by law. *Atwood* rule stated as the general rule in Rummens v. Home Savings and Loan Ass'n, 182 Wash 539, 543, 47 P.(2d) 845 (1935).

123 BALLANTINE, CORPORATIONS (Rev. Ed.) § 342.

CONCLUSIONS

The general provisions of the Uniform Business Corporations Act on shareholders' liabilities to creditors for unpaid subscriptions is little different from our earliest statute. As construed, the Act has left the case law essentially as it had previously been laid down by the courts. We may conclude that in the future trust language will be sparingly used, but the case holdings decided under that theory are unquestionably alive. Properly presented, they should be compelling upon our court. The true stock subscription action seems to be currently viewed as having its germ in contract with an equitable power to sue in the receiver or creditors. The power to sue is based on operation of statute or broad equity rules, rather than trust theory This is surely a sound semantic development and accords with the trend in other jurisdictions. However, insolvency cases have been relatively scarce in this prosperous decade and the shape of the new approach is not yet certain.

The watered stock problems have been reduced but by no means eliminated through use of no-par and nominal-par shares. In this area the "fraud" theory of recovery is firmly settled but sound policy may dictate a broadening of creditors' rights by statute. A pragmatic rule seems desirable that will allow all creditors to compel the payment by a subscriber of full par value or full subscription price, whichever is greater, in event of corporate insolvency In the absence of estoppel, waiver or other bar to his action, no creditor, whether he has relied on the capital stock or not, should be denied the right to reach subscriptions.

The statute should provide that the creditors' remedies continue to be equitable in nature and maintain procedural protection for the subscribers. The court should have power under proper circumstances to require all subscribers to pay the full amount of their subscription to the receiver for equitable distribution among the creditors *and* paid up shareholders upon insolvency

There is a need for definite rules burdened by no underlying artificial theory and based plainly upon a policy to protect creditors and shareholders alike from subscribers seeking to retain an expectant interest in corporate success while insulating themselves from the responsibilities of corporate failure.