1895

Preferential Assignments of Insolvent Corporations

Allen T. Stewart

Cornell Law School

Follow this and additional works at: http://scholarship.law.cornell.edu/historical_theses

Part of the Bankruptcy Law Commons, and the Corporation and Enterprise Law Commons

Recommended Citation

Stewart, Allen T., "Preferential Assignments of Insolvent Corporations" (1895). Historical Theses and Dissertations Collection. Paper 42.
T I E S I S

P R E F E R E N T I A L  A S S I G N M E N T S

O F  I N S O L V E N T  C O R P O R A T I O N S.

Presented for the Degree of

Bachelor of Laws

by

Allen T. Stewart.

Cornell University.

1895.
CONTENTS

I. -- PRELIMINARY.------------------------------------------ 6

II. DEFINITIONS.--
Voluntary Assignments. ------------------------------- 7
Preferential Assignments----------------------------- 7
Insolvency. ------------------------------------------ 7
Contemplation of Insolvency. ------------------------ 8

III. -- THE RIGHT TO PREFER.
Origin. ----------------------------------------------- 9
Criticism of Reasoning------------------------------- 11
General Doctrine. ---------------------------------- 12

IV. -- THE RIGHT TO PREFER STOCKHOLDERS.
Where held. ------------------------------------------ 14
Discussion of Cases. -------------------------------- 15

V. -- THE RIGHT TO PREFER DIRECTORS.
Where held. ------------------------------------------ 16
Discussion of Cases. -------------------------------- 17
Criticism of Reasoning. ------------------------- 20

VI. -- THE TRUST FUND DOCTRINE.

Origin. ----------------------------------------- 23

Where held. ------------------------------------- 23

Cases Examined. ---------------------------------- 24

Criticism. --------------------------------------- 25

VII. -- THE PREVAILING RULE.

What is. ---------------------------------------- 29

Where held. ------------------------------------- 30

VIII. -- CONCLUSION. ----------------------------- 33
# Table of Cases

<table>
<thead>
<tr>
<th>Case Name</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allis v. Jones</td>
<td>14</td>
</tr>
<tr>
<td>Adams v. Milling Co.</td>
<td>26</td>
</tr>
<tr>
<td>Bartlett v. Tear</td>
<td>7</td>
</tr>
<tr>
<td>Bank of Montreal v. Potts Co.</td>
<td>16</td>
</tr>
<tr>
<td>Beach v. Miller</td>
<td>21</td>
</tr>
<tr>
<td>Bocworth v. Jacksonville</td>
<td>29</td>
</tr>
<tr>
<td>Butler Paper Co. v. Robbins</td>
<td>29</td>
</tr>
<tr>
<td>Brown v. Grand Rapids Furniture Co.</td>
<td>19</td>
</tr>
<tr>
<td>Buell v. Buckingham</td>
<td>12</td>
</tr>
<tr>
<td>Catlin v. Eagle Bank</td>
<td>8</td>
</tr>
<tr>
<td>Canover v. Iull</td>
<td>26</td>
</tr>
<tr>
<td>Case v. Beauregard</td>
<td>28</td>
</tr>
<tr>
<td>Curtis v. Leavitt</td>
<td>8</td>
</tr>
<tr>
<td>Covert v. Rogers</td>
<td>13</td>
</tr>
<tr>
<td>Coats v. Donnell</td>
<td>13</td>
</tr>
<tr>
<td>Curan v. Arkansas</td>
<td>26</td>
</tr>
<tr>
<td>Craigs Appeal</td>
<td>29</td>
</tr>
<tr>
<td>Corey v. Wadsworth</td>
<td>29</td>
</tr>
</tbody>
</table>
Dana v. Bank of U. S. .............................................. 14
Foster v. Mullanphy Plaining Co. .................. 17
Fogg v. Blair .................................................. 25
Garrett v. Plow Co. ............................................. 14
Gould v. Little Rock Co. ................................. 16

Hays v. Citizens Bk. .......................................... 29
Hopkins Appeal .................................................. 29
Hill v. Pioneer Co. ........................................... 29
Hill v. Knickerbocker Electric Co. ................. 22
Hospes v. Car Co. ............................................. 27
Hollins v. Brierfield Coal Co. ....................... 27

Lane v. Wheelright ........................................... 22
Lamb v. Laughlin .............................................. 29
Liepold v. Marony ............................................ 26
Lowrey Co. v. Empire Co. ............................... 29

Marr v. Bank .................................................. 26
Mosby v. Williamson ........................................ 26
Mc Queen v. New ............................................. 22
Olney v. Conanicut Land Co. .............................. 29

Ringo v. Biscoe. ............................................ 13

Rollins v. Sharer Co. ................................. 16

Rouse v. Merchants Natl. Bank. .................. 26

Reichwald v. Comm. Hotel Co. .................... 16

Sanger v. Upton.................................................. 25

Sargent v. Webster. ................................. 14

Sicardi v. Keystone Oil Co. ...................... 29

Smith v. Mc Groarty ................................. 26

Smith v. Skeary ............................................ 14

Smith v. Putnam ........................................... 29

Suo ton Mfg. Co. v. Hutchingson ................ 29

Taylor v. Miami Exp. Co. ............................ 26

Thomas v. Jenks ............................................ 9

Upton v. Tribilock ...................................... 21

Warner v. Mower ............................................. 14

Warfield v. Marshall Co. Canning Co. ........ 14

Whitwell v. Warner ...................................... 16

Wilkinson v. Baurle ..................................... 14
I. PRELIMINARY.- The numerous instances of corporate failures during the late period of financial stringency, coupled with the fact that a majority of these failures have been accompanied with an attempt on the part of the managers or officers to give preferences to certain creditors, over others and in many instances to the stockholders and directors of the corporation themselves—gives enhanced interest to the inquiry, whether and to what extent the law will allow a preferential transfer of property to be made by a corporation with failing circumstances.

The right of an individual to give preferences has never been questioned; and the first case, (1) in which the validity of preferential assignments by corporations was questioned, seemed to have taken the learned court of Connecticut by surprise, for Josmer C. J. in delivering the opinion of the court, remarks:—"There exists no doubt that there have been many instances of actually insolvent corporations, where certain creditors have been preferred to others, and the perfect silence till now, on the subject of this fancied

(1) Catlin v. Eagle Bank, (6 Conn. 233.)
diversity," (between an individual and a corporation) "is powerful to show what has been the universal opinion."

II. DEFINITIONS.- In the discussion of this question, numerous factors are involved and to the better understanding of the subject, it is first necessary to ascertain the meaning of (a) Voluntary assignment; (b) Preferential assignments; (c) Insolvency, and (d) In contemplation of insolvency.

(a) Voluntary assignments for the benefit of creditors are transfers without compulsion of law, by debtors, of some or all of their property, to an assignee or assignees, in trust to apply the same, or the proceeds thereof, to the payment of some, or all of their debts, and to return the surplus if any, to the debtor. (1)

(b) A preferential assignment may be defined as an assignment of property for the benefit of creditors, made by an insolvent debtor in which he has directed that a preference (right to be paid first) shall be given to a creditor or creditors therein named.

(c) "Insolvency" says Brown J., "is the inability of a company and the inadequacy of its property to pay its debts, and not a present inability to pay in cash or its equive-

(1) Burrill on Assignments, Fifth Ed. p. 3. and app. in Bertlett v. Teah, (1 Mc Crary 176.)
lent." (1)

"A contemplation of insolvency is where a debtor, having full knowledge of his embarrassed circumstances, has no hope or expectation of relief, and anticipates an entire failure in business, and absolute insolvency; or where his circumstances are such, that any prudent man, taking a reasonable view of his situation, and of the surrounding circumstances, might at any time fairly expect insolvency to follow." (2)

From these definitions it must necessarily follow, that notwithstanding the pressure of great embarrassments, if a debtor corporation entertains an honest intention and expectation, in the exercise of reasonable intelligence, of weathering the storm, of going on with his business, and paying all its debts, its acts cannot be brought within the provisions of a statute prohibiting preferences.

III. THE RIGHT TO PREFER.— In the absence of statutory prohibitions or restrictions to the contrary, a corporation has the same right to make an assignment and to give preferences as an individual. Whatever may be thought of the justice of allowing a debtor to make an assignment with preferences, its legality at common law is indubitable.

"Having an unquestionable power of preference, of which he is the absolute master, it follows that he may set his price

---

(1) and (2) Curtis v. Leavitt, (15 N.Y. 150.)
upon it, provided it is not a reservation of part of the effects for himself, or anything that would carry his power beyond a mere preference." (1)

Upon the right of an insolvent corporation to prefer one creditor to another, the case of Catlin v. Eagle Bank of New Haven, cited supra, decided in 1826, is the first of any note in this country and is continually being cited as a leading case. The bank, having become insolvent assigned to one of its customers $52,000 in notes, gave him a mortgage on real estate for $20,000. and paid him $15,000. in money. The amount of the deposit thus secured was eighty or ninety thousand dollars. It does not appear whether the bank ceased to be a going concern, but only that it was actually insolvent, when the preference was made. "The corporation had authority to purchase, hold and convey property, with the usual banking powers super-added; and the directors were authorized to dispose of and manage its moneys, credits and property, and to regulate its concern in all cases not specially provided for." To this general grant there is neither exception nor limitation, "except that the charter is alterable, amendable, and revocable at the pleasure of the legislature."

(1) Thomas v. Jenks, 5 Rawle(Pa.) 221
The question before the court for consideration was whether the directors of the corporation after it had become actually insolvent, can make payment or give security to one of its creditors and have another unpaid and without security. And the court answered the question in the affirmative. In the course of his opinion, Hosmer C.J. said, "A corporation is an artificial person; and this designation is given it by reason of its resemblance to a natural person, in respect to its rights, powers, and legal duties. It is difficult for me to conceive, where no restraint is interposed in a charter of incorporation, on what ground, the general authority delegated, is subject to exceptions or fettered by restrictions from which an individual or an merchantile company are free. And this difficulty is much increased as no case intimating this diversity between corporations and individuals has been cited, nor can be found by my utmost researches......... The cases of an individual and a corporation in the matter under discussion, it appears to me, are not merely analogous but identical, and I discern no reason for the slightest difference between them. The exists no doubt that there have been many instances of actually insolvent corporations, where certain creditors have been preferred to others, and the perfect silence till now, on the subject of this fancied diversity, is powerful to show
what has been the universal opinion."

The argument of the Court in this case proceeds upon

the ground that any insolvent corporation may make an assignment with preferences, and upon the ground that the cases of an individual and a corporation are "not merely analogous but identical." A corporation merely insolvent and one that has become so insolvent, that it can no longer transact business; or that the directors or managers, by reason of its insolvency, have decided to wind up its business and dissolve it; these two classes are put upon the same footing. The Court does not seem to grasp this distinction; nor the one between an individual and corporation. The insolvency of a corporation is practically the end of its business career, being the equivalent to the death of an individual. An individual, upon becoming insolvent retains possession of his property until voluntarily or involuntarily disposed of.

The creditors of a corporation have the entire beneficial interest in its assets, the entire property interests therein, except the right to possession and the naked legal title. An individual being stripped of his property, leaving his debts unpaid, has still another business career before him, with his property, afterwards acquired, liable for the unpaid residue of his debts. Upon the insolvency of a corporation the fiction of its being a person is partly thrown off or
discarded; actually no such person ever existed, and this fact is recognized to a certain extent, so that the fictitious person no longer has either actual possession of the corporate assets, nor any beneficial interests therein, but merely the naked legal title; while the directors have possession and the creditors the entire beneficial interest. The court in the case of Catlin v. Fable Bank, seems to have overlooked these distinctions, but it entertained grave fears that if it established the rule that an insolvent corporation could not prefer its creditors, great inconvenience would result to trading corporations, and their usefulness much impaired.

Had the courts in the early stages of the evolution of corporation law, recognized these fundamental differences between an insolvent individual and an insolvent corporation, it is doubtful if this inequitable doctrine of preferences would ever had existed to any great extent, in our corporation law.

Another leading case holding the right of a corporation to give preferences is, Buell v. Buckingham (1) decided in 1864. The corporation owed one Buell over $7500 for money previously advanced by him and in the consideration of a

(1) Buell v. Buckingham, 16 Iowa 284.
conveyance to him of five or six thousand dollars worth of property, he agreed to pay the debts of the corporation amounting to nearly $2000, and apply the remainder on his claim. The corporation also owed him $2000 worth of stock, which they had promised but never issued to him. The court held that the corporation might thus prefer him. But it is to be observed in the language of Coe J., that, "there is no evidence in the case, that the corporation was insolvent, or that the sale to Buell embraced all its property, but if such facts were shown, since the transaction was an absolute sale in good faith, for a valuable consideration and not a mortgage, a pledge or an assignment, with any contingent interest remaining in the grantor it cannot under the decisions of this court be held a general assignment, and therefore void."

Notwithstanding the disfavor in which preferences are held by some courts, the doctrine of the majority of the cases is that, corporations when insolvent, or in contemplation of insolvency, may dispose of their assets so as to prefer favored creditors, although the result may leave nothing for others, who stand on a footing equally meritorious. (1)

IV. THE RIGHT TO PREFER STOCKHOLDERS -- In considering the right of corporations to prefer creditors generally, stockholders have usually been regarded as outside creditors, and preferences to them, therefore valid, but in the present instance, it has been thought wise to treat them separately. That stockholders are allowed to receive preferences in some jurisdictions, is unquestioned. Thus, in Sargent v. Webster, (1) where the directors of a manufacturing corporation voted that an assignment of all the property of the corporation should be made to Sargent, one of the stockholders (who was liable for a large amount as indorser for the corporation) for the payment of his endorsment, and

Dana v. Bank of U. S., 5 W. S. (Pa.) 223;
Garet v. Plough Co., 70 Iowa 697.
Wilkinson v. Bauerle, 41 N. J. E. 635, s. c. 7 At. Rep. 514
Warfield v. Marshall Co. Canning Co. 72 Ia. 666
compare with Barrings v. Dabney 19 Wal. 1.
Smith v. Skeary, 47 Conn. 47.

(1) Sargent v. Webster, 13 Metcalf (Mass.) 497.
authorized the treasurer to make such an assignment, and sign it as treasurer. The treasurer made a deed of release and quit claim to sargent of all the property, real and personal of the corporation, and constituted Sargent the attorney of the corporation, to sue for and recover all monies due, and all property belonging to the corporation. This conveyance was objected to on the ground that it tended to give a preference to a stockholder and thus a fraud against creditors. But Shaw C. J., said, "Such a conveyance would now be fraudulent, if made by an individual, because it would be repugnant to the spirit and letter of the insolvent laws. But as corporations are not subject to the insolvent laws and the law stands, in regard to them as it did before, these provisions do not apply."

A transfer of this kind would be fraudulent if made by an individual because "repugnant to the letter and spirit of the insolvent laws; but as corporations are on a better footing than individuals, as they were not subject to the insolvent laws and as their acts were in furtherance of the purposes of the corporation, to wit: to pay its debts, and go on successfully with its business, or to wind it up, and settle-on terms most advantageous to the stockholders-the court sustained the assignment.

In another jurisdiction there is also a case holding
that the stockholders of a corporation, who avail themselves of their superior advantages for the purpose of obtaining security, from the property of the corporation for debts due themselves, are not thereby guilty of fraud, in contemplation of law so as to render themselves personally liable to the creditors. (1)

V. THE RIGHT TO PREFER DIRECTORS.-- The doctrine that a corporation may prefer creditors, has been carried to the extent in absence of statutory provisions to the contrary, that it may even prefer its own directors in Arkansas, Connecticut, Iowa, and Michigan. (2) "This infamous doctrine", says My. Thompson,(3) "has been pushed to the extent of allowing directors and shareholders of a corporation to prefer themselves at the expense of its creditors at large, although

(1) Whitwell v. Warner, 20 Vt. 425;
Reichwald v. Commercial Hotel Co., 106 Ill. 439.

(2) Smith v. Skeary, 47 Conn. 47;
Collins v. Sharer Co., 80 Iowa 380;
Bank of Montreal v. Potts Co., 90 Mich. 345;
the directors or shareholders may have voted for the proposition." (1)

Mr. Thompson continues in condemning this "infamous doctrine," "It cannot escape attention that this doctrine offers a new inducement to the corporations of every species of business, because it gives the members of corporations an advantage over their creditors which the members of a partnership do not possess. A partnership cannot distribute its assets to its partners in preference to its creditors; but under this miserable doctrine, if it becomes incorporated, it can do so."

The analogy between a corporation and a partnership in this regard is not very clear. Distinctions which seem to have escaped Mr. Thompson, placed the directors of corporations and members of partnerships in two entirely different categories. In the first place the reason why a partnership cannot prefer its partners is simply that it cannot owe one of its partners; and where there is no debt, there can be no debtor to make a preference, and no creditor to be preferred; second, there is a personal obligation attaching to each partner to pay all the debts of the partnership; while direc-

Foster v. Mullanphy Plaining Mill Co., 92 Mo. 79.
tors as such are under no common law liability to pay any of the debts of the corporation; and finally, if we discard the idea if a fictitious person, and look upon the corporation as composed of individual members, even then the directors would be merely the managing partners of the company, and if a preference to a creditor is to be held void on the ground of a debtor preferring himself, then an assignment preferring a stockholder, must be held void for the same reason; with which conclusion many jurists are hearty accord, but their position cannot be sustained on the authorities.

However unfortunate Mr. Thompson may have been in his selection of comparisons, or however unsound his reasoning, his conclusions seem to be just; for it is difficult to understand the reasoning upon which preferences to directors are to be substantiated.

In the early cases of preferential assignments of corporations, the broad general statement was continually being made that a corporation could make assignments and give preferences as fully and to the same extent as natural persons, without exception or modification as to directors, simply because that point was not involved in the case, while it is very probable that such exception would have been made, had that been a point in issue. It is in this account, viz. of relying so strongly on such broad and general statements,
made without exception, restriction or modification that we find this extreme view in Arkansas, Iowa, Connecticut and Michigan.

Attempts have been made from time to time to put this doctrine upon a logical basis, and many reasons have been advanced for its existence. For example, Taft J. in Brown vs. Grand Rapids Furniture Co. (1), gives us the following reason:

"But we do not find any reason why, if a corporation may prefer one creditor over others, it may not prefer a director, who is a bona fide creditor. Preferences are not based on any equitable principle. They go by favor, and as an individual may prefer among his creditors his friends and relatives, so a corporation may prefer its friends."

It will be seen that this reasoning is not well founded; it is not based upon any principle; and it makes use of a comparison, the individual, faulty and erroneous when applied to corporations. But in the Arkansas Supreme Court, we find an attempt to defend this doctrine upon general principles. In Worthen v. Griffith, (2), we find the following: "The directors of a corporation are neither trustees nor agents of

the creditors, and they do not occupy a fiduciary relation to
them...... The very fact that preferences are made, shows
always that the party making them is biased more or less to-
ward the person in whose favor they are made. As long as
preferences are allowed to be made by insolvent debtors, they
will be dictated more or less by the bias of the person making
them. The individual debtor when insolvent and forced to
make an assignment, generally prefers his friends, and often
members of his own family. The home creditor and neighbor
is preferred at the expense of the non-resident, one perhaps
equally deserving..... The contention that the estate of an
insolvent debtor should be dispersed by some one acting
without bias or personal interest, would apply almost as
well to the case of an assignment of an insolvent individ-
ual or partnership as that of a corporation, and if adopted
would result in forbidding all preferences in assignments
by insolvent debtors, a result that might be productive of
much good but it is one that the courts must leave to the wis-
dom of the legislature to accomplish."

This reasoning is unsound both on reason and authority,
so far as it denies the fiduciary relation existing between
directors and creditors.

"The capital stock of a moneyed corporation" says Mr.
Justice Hunt in the case of Upton v. Trivilock, "is a trust
fund of which the directors are trustees. It is a trust to be managed for the benefit of its stockholders during its life, and for the benefit of creditors in the event of dissolution." (1)

Also in Beach v. Miller (2), the court said, "So long as a corporation remains solvent its directors are agents or trustees for the shareholders. But the moment a corporation becomes insolvent its directors occupy a different relation. The assets of the corporation must then be regarded as a trust fund for the payment of its creditors, and the directors occupy the position of trustees and a fiduciary relation exists."

As before indicated sharp distinctions are to be drawn between the cases in which a corporation, though actually insolvent, secures a director with an actual and reasonable expectation of paying its debts and continuing its business, or in which a director receives payment or takes security contemporaneously with making sales or advances. Keeping these distinctions in mind it is safe to say that Arkansas, Connecticut, Iowa, and Michigan stand alone in the exceptional doctrine above treated.

(1) Upton v. Tribilock, 91 U. S. 56.
(2) Beach v. Miller, 130 Ill. 162, 170.
There are also a few decisions in the lower courts of New York City, holding that a director of an insolvent corporation being also a creditor may receive a preference over other creditors. (1)

"These cases cannot be held to settle the law in New York, as to the right of a director of an insolvent foreign corporation to obtain a preference from its property in this State, by either voluntary or involuntary transfer, on common law principles assuming that the statutes of New York as to preferences by insolvent corporations are not applicable to foreign corporations." (2)

The text writers almost unanimously attack this doctrine with great vigor. (3)

Lane v. Wheelright, 89 U. S. 180.
Mc Queen v. New, 10 Misc. 251.


(3) Taylor on Corp. 3ed. Secs. 668, 759.
Cook on Stock 1. 3ed. secs. 661-2
Spelling on Corps. secs. 714, 809.
Morawetz, on Corps. secs. 787-8.
Upon the doctrine laid down in the quotations, (p.p. 20, 21.) there are numerous authorities, supporting it; the consideration of which leads to the discussion of:

V I.- THE TRUST FUND DOCTRINE. Opposed to the courts of Arkansas, Connecticut, Iowa, and Michigan stand the courts of Ohio, Tennessee, Texas, and Washington, asserting the equally exceptional doctrine that the assets of an insolvent corporation are a trust fund for the benefit of the creditors ratably.

This doctrine commonly known as the "American Doctrine" has given rise to much confusion of ideas as to its real meaning and much conflict of decision in its application. (1)

The Trust Fund doctrine, so called, was invented by Mr. Justice Story in the case of Wood v. Drummer (2). This case did not demand any such invention, it being a case of fraud upon creditors upon old and familiar principles of law. A bank divided up two thirds of its capital among its stockholders, without providing funds sufficient to pay its outstanding creditors. In the course of his opinion, Mr. Justice Story says:—"It appears very clear to me upon general

(1) Two N. W. L. Rev. p. 169.

(2) Wood v. Drummer, 3 Mason 308.
principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank.

The Public, as well as the legislature, have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable in their private capacities. The charter releive them from personal responsibility, and substitutes the capital in its stead; credit is universally given to this fund by the public as the only means of repayment. During the existence of the corporation it is the sole property of the corporation, and can be applied only according to its charter, that is a fund for the payment of its debts, upon the security of which it may discount and circulate notes. Why otherwise is any capital stock required by our charters? If the capital stock, may the next day after it is paid in, be withdrawn by the stockholders without payment of the debts of the corporation, why is this amount so studiously provided for? and its payment so dilligently required? To me this point seems so plain upon principles of law as well as common sense, that I cannot be brought into any doubt, that the charters of our banks, make the capital stock a trust fund, for the payment of all the debts of the corporation. The stockholders and other creditors have the first claim upon it; and the stockholders have no
rights until all the other creditors are satisfied. They
have the full benefit of all the profits made by the estab-
lishment; and cannot take any portion of the fund, until all
other claims on it are extinguished."

What the eminent jurist meant by these propositions
has been the cause of much controversy among the members of
the bench and bar. It has been said that Mr. Story meant
merely, that corporate property must be first appropriated
to the payment of the debts of the corporation before there
can be any distribution of it among the stockholders. This
seems to be a rationable and reasonable construction of the
proposition as laid down in Wood v. Drummer, supra, and as a
proposition itself has never been disputed. This view is
sustained in Fogg v. Blair. (1)

Notwithstanding the evident intent of Judge Story and
the version placed upon the trust fund doctrine in the au-
torities cited above, many cases have followed blindly and
implicitly the fraze, 'That the capital stock of the corpora-
tion is a trust fund for the benefit of all creditors rat-
ably.'

Thus, in Sanger v. Upton, (2) Mr Justice Swain lays it


(2) Sanger v. Upton, 91 U. S. 56.
down that, "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 liabilities which subsist in private co-partnership. When debts are incurred, a contest arises with the creditors that it shall not be withdrawn or applied otherwise than upon their demands until such demands are satisfied. The creditors have a lien upon it in equity; if diverted they can follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it bona fide for a valuable consideration without notice." (1)

(1) Curran v. Arkansas, 15 How. 312;
    Upton v. Tribilock, 91 U. S. 45,
    Taylor v. Miami Exp. Co., 5 Ohio St. 165,
    Rouse v. Merchants Natl Bk., 46 Ohio St. 493,
    followed in,
    Smith Co. v. McGroarty, 136 U. S. 237,
    Marr v. Bank, 4 Coldw. (Tenn) 471,
    Moseby v. Williamson, 5 Iusk (Tenn) 278,
    Leipold v. Marrony, 7 Lea (Tenn) 128,
    Lyons-Thomas Co v. Perry Store Mfg. Co. 88 Tex. 143,
    Canover v. Howe, 39 Pac. Wash. 741.
In these cases the capital stock of a corporation is held to be a trust fund for the benefit of all creditors ratably. This necessarily raises the questions:-(a) What is necessary to create a valid trust? And (b) Does this come within the meaning? And first as to a trust. In the proper sense of the term no trust is created. A trust always implies two estates, one legal and the other equitable; it implies two personages holding these two estates or interests, one person called trustee holding the legal, and another called cestui qui trust has the equitable interest.

Second: The application of this conception of a trust to the case in hand. The capital stock of a corporation is its own property; it holds the legal title and has the beneficial interest; it has absolute power of disposition and this is incompatible with the generally accepted idea of a trust. (1)

The following extract from the opinion of Mr Justice Brewer in Hollins v. Brierfield Coal Co., (2), is exactly in point. "While it is true language has been frequently used to the effect that the assets of the corporation are a trust fund held by a corporation for the benefit of creditors, this has not been to convey the idea that there is a direct and express trust attached to the property."

(1) Iospes v. Car Co., 50 L. W. 1117.
Again in Vol. II. Pomeroy's Equity Jur. Sec. 1046, they "are not in any true and complete sense trusts, and can only be called so by way of analogy or metaphor."

However misleading may have been the phrase, the capital stock of a corporation constitutes a trust fund for the benefit of all creditors ratably, since the decisions in the two cases of Collins v. Brierfield Coal Co. and Iospes v. Car Co., there seems but little reason why any one should be led astray by the term "trust fund" as used in the case of Wood v. Drummer. The directors were called trustees for the benefit of creditors after a corporation had become insolvent because it is said, the insolvency of a corporation makes the corporate property a trust fund, and therefore makes the directors trustees of that fund. But the two cases last above cited, show that the trust is "rather a trust in the administration of the assets after possession by a court of Equity, than a trust attaching to the property as such, for the direct benefit of either creditors or stockholders." A trust in the administration of the assets is no trust at all, but simply a rule governing the court in the distribution of those assets. And it is a well settled principle of the law of partnership, where there is a similar trust in the administration of assets, there is no trust that can be enforced until the property has passed in custodiam legis. (1)

V I I - THE PREVAILING DOCTRINE. -- Between the two extremes above considered lies the unquestioned weight of authority, asserting the common law right of a corporation to prefer its creditors as freely as a natural person, denying only the right of a director to obtain or receive preferences over other creditors. (1) The States holding this doctrine deny the right of a director to receive or obtain a preference over other creditors for a two fold reason, viz: (first) the trust fund doctrine, and (second) the fiduciary relation.

(1) Sutton Mfg. Co. v. Hutningson, 63 Fed Rep. 496,
    Bosworth v. Jacksonville, 64 Fed. Rep., 615,
    Smith v. Putnam, 61 N. J. 632,
    Hill v. Pioneer Co., 18 S. E. 107,
    Sicardi v. Keystone Oil Co., 149 Pa. St. 148,
    Craig's App. 92 Pa. St. 396,
    Iopkins App., 90 Pa. St. 69,
    Olney v. Conanicut Land Co., 16 R. I. 597,
    Lamb v. Laughlin, 25 W. Va. 300,
    Corey v. Wadsworth, 99 Ala. 68,
    Lowry Co. v. Empire Co., 91 Ga. 624,
    Butler Paper Co. v. Robbins, 151 Ill. 588,
    Iays v. Citizens Bank, 51 Kansas 535.
Both of these reasons for denying a preference to directors are well stated in one of the latest and most authoritative decisions on the subject, (Sutton Mfg. Co. v. Hutcheson), which arose in Indiana. I quote from the opinion of Justice Iarlan as follows: "The contention of the defendants is that in disposing of their respective properties: an individual and a corporation were recognized at common law as having equal rights; and, as the former may, in the absence of a statute forbidding it, transfer the whole or part of his property with the intention or with the effect of giving a preference to some of his creditors to the exclusion of others, so an insolvent corporation, when financially embarrassed and not intending to continue its business, may make a preference among its creditors, whoever they may be, and whatever their relation to the corporation or to the property transferred. If this be a sound rule, it would follow that directors, being also creditors, of an insolvent corporation, which has abandoned the objects of its creation and ceased an active existence, may distribute among themselves its entire assets, if the reasonable value thereof does not exceed their aggregate demands. We cannot accept this view. In our judgment, when a corporation becomes insolvent and intends not to prosecute its business, or does not expect to make further efforts to accomplish the objects of its creation, its mana-
ging officers or directors come under a duty to distribute its property or its proceeds ratably among all creditors, having regard of course to valid liens or charges previously placed upon it. Their duty is "to act up to the end or design" for which the corporation was created (1 Bl. Comm. 480.) and when they can no longer do so their function is to hold or distribute the property in their hands for the equal benefit of those entitled to it. Because of the existence of this duty in respect to a common fund in their hands to be administered, the law will not permit them, although creditors to obtain any peculiar advantage for themselves to the prejudice of other creditors. This rule is imperatively demanded by the principle that one who has the possession and control of property for the benefit of others—surely an insolvent corporation, which has ceased to do business, holds its property for the benefit of creditors—may not dispose of it for his own special advantage to the injury of any of those for whom it is held. That principle pervades the entire law regulating the conduct of those who hold fiduciary relations to others. And, instead of being relaxed, should be rigidly enforced in cases of breach of duty or trust by corporate managers seeking to enrich themselves at the expense of those who have an interest equally with themselves in the property committed by law to their control. It would be difficult to overstate the mischievous results of a contrary rule, as
applied to those entrusted with the management of corporate property....

As in the absence of a statute prescribing a contrary rule, creditors of a private corporation cannot look for their security to the private estate either of the corporators or of those who manage its property, the only recourse of creditors, when a corporation is dissolved or becomes insolvent and ceases to prosecute its business, is the property in the hands of its managing officers. The law in effect says to all who deal with private corporations that they must look to its property as the only security for the fulfillment of its obligations; and, if the law gives this assurance to creditors of a corporation, those who are authorized to represent it in its dealings with the public, who control and manage its property, and upon whose fidelity and integrity the public as well as creditors rely, ought not to be permitted, when the corporation becomes insolvent and abandones the objects for which it was created, to appropriate to themselves any more of the common fund in their hands than is ratably their share. If, upon becoming insolvent, a corporation should invoke the aid of a Court of Equity for the distribution of its assets, creditors would be paid pari passu in ratable proportions. Those, therefore, who hold fiduciary relations to creditors ought not to be allowed by any form of
proceeding, or by their own act, after the corporation is practically extinct, to appropriate its property for their special benefit, to the injury of those who, upon every principle of justice, have equal rights with themselves."

V I I I - CONCLUSION.--- Nearly every State in the Union has passed laws, restricting, more or less the right of an insolvent corporation to prefer creditors and more especially the right to prefer its own directors, and even in those States where preferences are allowed, they are looked upon with disfavor, and the text writers have been almost unanimous in attacking the right with even more vigor than the courts which reject it.

Wait, at Sec. 162, says:- "The practical working of the rule sustaining corporate preferences is monstrous. Unpreferred creditors have only a myth or a shadow left to which resort can be had for payment of their claims; a soulless, fictitious, unsubstantial entity that can be neither seen nor found. The capital and assets of the corporation, the creditor's trust fund, may under this rule, be carved out and apportioned among a chosen few, usually the family connections or immediate friends of the officers making the preference. This rule of law is entitled to take precedence among the many reckless absurdities to be met with in the
cases affecting corporations, as being a manifest travesty upon natural justice."

Taylor at Sec. 668, says: "To allow a corporation to make an assignment of its property, giving a preference to a portion of its creditors over others, is unjust, as well as utterly repugnant to the doctrine that corporate property is a trust fund, on the credit of which persons contract with the corporation."

Although these authorities urge the trust fund doctrine as one of the reasons against preferences, which doctrine was exploded in the case of Jospes v. Car Co., still, their conclusions are worthy of notice, as showing the disfavor in which preferences, as a whole, are held.

In the early case allowing a corporation to make an assignment with preferences, notably, Catlin v. Eagle Bk., the right was based upon the supposed analogy between an insolvent individual and an insolvent corporation; and following this fallacious reasoning, they stated it in broad general terms that a corporation could prefer creditors as freely and to the same extent as an individual, not even excepting a director, simply because the point was not raised in the case. The result is, we have the assets of a corporation disposed of according to the caprice or whim of the debtor, excluding some creditors, as meritorious at least, as the preferred
ones; as a result also, we have that anomaly in American Jurisprudence, the Trust Fund doctrine, invented in a case calling for no such invention. Consequently our corporation law in regard to the distribution of corporate assets after insolvency, is in a rather of a chaotic state; on the one hand we have States, following blindly the flaccid reasoning of Catlin v. Eagle Bk., and asserting the doctrine that directors may receive preferences to the same extent as outside creditors; and, on the other hand we have courts asserting the equally exceptional doctrine that the assets of a corporation are a trust fund for the benefit of all creditors ratably. —The Trust Fund Doctrine.

This doctrine of allowing preferences is not based upon any idea of justice or equity, but its justification is to be found in the reverence the common law judges had for precedent, and the fear they entertained of impairing the usefulness of trading corporations, were they to forbid preferences; but public opinion is rapidly turning against this unjust and inequitable doctrine, and, undoubtedly it will soon be supplanted by a more equitable one, "a result that might be productive of much good, but it is one that the courts must leave to the wisdom of the legislatures to accomplish." (1)

(1) Worthen v. Griffith, 28 S. W. 286.