Washington Law Review

Volume 16 | Number 4

11-1-1941

The Rights of Corporate Creditors Upon Unpaid and Watered Stock Subscriptions

Jane Sue Abernethy

WASHINGTON LAW REVIEW
and
STATE BAR JOURNAL

Published Quarterly, in January, April, July and November of Each Year by the Washington Law Review Association, at the Law School of the University of Washington. Founded by John T. Condon, First Dean of the Law School.

SUBSCRIPTON PRICE: $1.20 PER ANNUM. CURRENT COPIES 50c

CONTRIBUTORS TO THIS ISSUE

WIGLE, MARYHELEN, LL.B. University of Washington, 1935. Member of the Seattle bar.

With the beginning of the fall quarter of this year the first class which entered the law school under the four-year curriculum, inaugurated in 1938, enters upon its fourth year studies. To meet the added teaching burden imposed upon the faculty, especially by reason of the seminars in which each student must now be enrolled, two members have been added to the law faculty this year.

Associate Professor Robert L. Taylor, B.A. 1927, Yale University, J.D. 1930, Northwestern University, taught in the law schools of Valparaiso University and the University of Louisville after several years as an officer of an Illinois bank. During the past year he was Sterling Fellow at Yale University, where he did graduate work in law. Professor Taylor's field is commercial law, and he will teach the courses in Bills and Notes, Insurance, and Public Utilities as well as joining with Professor Shattuck in conducting a seminar in Banking Law and Advanced Problems in Security.

Assistant Professor Conrad W. Oberdorfer, LL.B. 1939, Northwestern University, LL.M. 1940, Harvard University, comes to the law school from Boston, Massachusetts, where he was associated in the practice of law with Herrick, Smith, Donald and Farley. Professor Oberdorfer will specialize in the field of public law, teaching the courses in Administrative Law, Federal Jurisdiction and Procedure, and Debtors' Estates and a seminar in Government Regulation of Business.

COMMENTS

THE RIGHTS OF CORPORATE CREDITORS UPON UNPAID AND WATERED STOCK SUBSCRIPTIONS[1]

There is a marked distinction between the purpose of an action instituted by a corporation while it is a going concern to recover unpaid subscriptions, and such an action instituted by a creditor or receiver[2] after insolvency.[3] In the former, the primary object is to collect money to further the business and purposes of the corporation and to continue it as a going concern. The corporation, but not a creditor, may proceed against any shareholder who has not paid for his stock in full, to recover the balance, whether or not such balance is necessarv to pay the obligations of the corporation, and independent suits may be begun against different shareholders. The corporation may sue part of the shareholders only, and it is no defense to such actions that there has been no marshalling of assets and liabilities, or that all of the delinquent shareholders have not been proceeded against.[4] But when the corporation becomes insolvent, the positive legal liability existing while the corporation was a going concern is transferred into an equitable liability[5] on the theory that these unpaid claims, on the corporation's insolvency, become part of a trust fund,[6] and that it would be inequitable to collect more from the shareholders on their obligations than is necessary to satisfy the corporation's debts.[7]

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[1] Decisions uniformly grant to the corporate creditor the right to compel payment of unpaid subscriptions to the extent necessary to satisfy his debt. Barnard Mfg. Co. v. Ralston, 71 Wash. 659, 129 Pac. 389 (1913); Dunlap v. Rauch, 24 Wash. 620, 64 Pac. 807 (1901); Adamant Mfg. Co. v. Wallace, 16 Wash. 614, 48 Pac. 415 (1897); Hatch v. Dana, 191 U. S. 205 (1880); Ogilvie v. Knox Ins. Co., 59 U. S. 577 (1859); Blood v. La Serena Land & Water Co., 150 Cal. 764, 89 Pac. 1090 (1907); Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388 (1900); 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS (3rd ed., 1932) § 6051.

[2] Chamberlain v. Piercy, 82 Wash. 157, 143 Pac. 977 (1914).

[3] As against creditors, a corporation is insolvent when it is unable to pay its debts in due course of business. Smith v. Solomon Valley Dredging Co., 147 Wash. 69, 264 Pac. 1009 (1928); McKnight v. Shadbolt, 98 Wash. 665, 168 Pac. 473 (1917); McKay v. Sperry Flour Co., 95 Wash. 209, 163 Pac. 377 (1917); Ronald v. Schoenfeld, 94 Wash. 238, 162 Pac. 43 (1917); Nixon v. Hendy Machine Works, 51 Wash. 419, 99 Pac. 11 (1909).

[4] Gaunce v. Schoder, 145 Wash. 604, 261 Pac. 393 (1927); Chamberlain v Piercy, *supra* note 2.

[5] A suit by the receiver of an insolvent corporation to recover unpaid subscriptions in an equitable proceeding. Gaunce v. Schoder, *supra* note 4; Chamberlain v. Piercy, *supra* note 2; Gordon v. Cummings, 78 Wash. 515, 139 Pac. 489 (1914); Lantz. v. Moeller, 76 Wash. 429, 136 Pac. 687 (1913); Adamant Mfg. Co. v. Wallace, *supra* note 1.

[6] Atwood v. McKenzie-Waterhouse Co., 120 Wash. 214, 206 Pac. 978 (1922); Hosner v. Conservative Casualty Co., 99 Wash. 161, 168 Pac. 1122 (1917); Murphy v. Panton, 96 Wash. 637, 165 Pac. 1064 (1917); Chamberlain v. Piercy, *supra* note 2; Lantz v. Moeller, *supra* note 5; Davies v. Ball, 64 Wash. 292, 116 Pac. 833 (1911); Cox v. Dickie, 48 Wash. 264, 93 Pac. 523 (1908); Dunlap v. Rauch, *supra* note 1; Manhattan Trust Co. v. Seattle Coal & Iron Co., 16 Wash. 499, 48 Pac. 333 (1897); Adamant Mfg. Co. v. Wallace, *supra* note 1; Patterson v. Lynde, 106 U. S. 519 (1908); Scovill v. Thayer, 105 U. S. 143 (1882); BALLANTINE, CORPORATIONS (1927) § 199 *et. seq.*

[7] See note 2, *supra.*

Usually there are constitutional or statutory provisions defining and regulating the shareholder's liability to pay creditors on the insolvency of the corporation. Under such provisions the amount of the liability is the difference between either the agreed price or the full par value and the amount actually paid for the stock, to the extent that such payment is necessary to satisfy their claims.[8] In the absence of such provisions, a similar common law liability exists, based upon various theories.[9]

The term "unpaid stock" embraces two distinct fields: (1) stock subscription contracts on which payments have not been completed, and (2) "watered" or bonus stock where the corporation has agreed to accept insufficient cash or property as full payment for the issued stock. Although the method of recovery in each case is similar, the theories of liability differ.

There are two theories of liability on unpaid stock, both of which have been followed by the Washington court: (1) the trust fund theory[10] and (2) the assets theory.[11] Under the trust fund theory, the capital stock of a corporation is treated as a trust fund for the payment of its debts in the sense that when the corporation is insolvent, all of its creditors are entitled in equity to have their debts paid out of the corporate property before there is any distribution thereof among the shareholders. Under the assets theory, unpaid subscriptions are treated as contractual obligations like any other assets of the corporation when it becomes insolvent, and may be collected through the interposition of the equity court, for the purpose of paying its debts.

"Watered" or bonus stock involves no unpaid subscription contract and liability to creditors must be placed upon grounds other than contract. The courts quite universally enforce this liability,[12] but on different theories:

(1) Trust fund theory—the *assets of the corporation* must be preserved as a fund for the payment of debts as against withdrawal by shareholders.[13] This theory fails to explain the rights of creditors

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[8] The nature, extent and condition of a shareholder's liability is determined by the law of the state of incorporation. Harrigan v. Bergdoll, 270 U. S. 560 (1926).

WASH. CONST., ART. 12, § 4: "Each stockholder in all incorporated companies except corporations organized for banking or insurance purposes, shall be liable for the debts of the corporation to the amount of his unpaid stock . . ."

WASH. LAWS 1933, c. 185, § 20; REM. REV. STAT. (Supp. 1939) § 3803-20: ". . . 2. A shareholder of a corporation . . . shall not be personally liable for any debt or liability of the corporation except every shareholder is individually and personally liable for the debts and liabilities of the corporation to the full amount unpaid on any subscription to shares of stock made by him."

[9] Note (1935) 33 MICH. L. REV. 1059.

[10] Atwood v. McKenzie-Waterhouse Co., *supra* note 6; Taylor v. Spurway, 16 F. Supp. 566 (S. D. Fla., 1936); BALLANTINE, CORPORATIONS (1927) § 199 *et seq.*

[11] Guaranty Trust Co. v. Satterwhite, 2 Wn. (2d) 252, 97 P. (2d) 1055 (1940); Guaranty Trust Co. v. Scoon, 144 Wash. 33, 256 Pac. 74 (1927); Hosner v. Conservative Casualty Co., *supra* note 6.

[12] BALLANTINE, CORPORATIONS (1927), § 210 *et seq.*

[13] The trust fund doctrine is described in Hospes v. N. W. Car Mfg. & Car Co., 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470 (1892). It is not recognized in New York, where contractual liability for stock subscriptions

where the corporation itself has no right or asset against the shareholder because bound by its contract with the shareholder.

(2) Fraud, or presumed reliance theory—the gist of the creditor's action is held to be that he was induced to extend credit to the corporation by false representations of the corporation respecting the amount paid in by the shareholder to corporate capital.[14] This seems to be the majority theory, and under it only creditors who have relied on the fictitious misrepresentation can recover. A subsequent creditor who has dealt with the corporation with full knowledge, cannot recover, nor can one who contracted with the corporation prior to the issue of watered stock.[15] A minority view makes no distinction between classes of creditors.

(3) Statutory obligation theory—the requirement of full payment is based on an inference from the statutory and limited liability privilege; hence liability is not affected by knowledge of the creditor, or by the fact that the creditor is prior or subsequent. The basis of the shareholder's liability is not any misrepresentation of fact as to the amount paid in, but an obligation imposed by law on the shareholder to contribute capital as an incident of membership in a limited liability corporation. The law assures to those dealing with the corporation that the whole of the subscribed capital shall remain available for the discharge of its liabilities except as diminished by business losses. The duty to contribute is imposed by law and is an asset of the corporation which may be called a "trust fund" in the sense that the corporation cannot dispense with or release it as against creditors.[16]

The Washington court has relied on all three theories at different times. The trust fund theory as applied to watered stock was followed in *Adamant Mfg. Co. v. Wallace*.[17] The fraud theory was the basis of liability in *Scovill v. Thayer*,[18] cited in *Elderkin v. Peterson*,[19] although it was also worked out on the trust fund theory. In *Johns v. Clother*,[20] the trust fund theory was mentioned, but the court also held that the constitution and statutes create a liability as a matter of law to the extent of the par value of the stock from the very fact of subscription, regardless of any attempted limitation of the contract of subscription. A somewhat similar rationalization was introduced in *Guaranty Trust Co. v. Satterwhite*,[21] where the court held that the

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alone is enforced. Jeffery v. Selwyn, 220 N. Y. 77, 115 N. E. 275 (1917). The doctrine is explained in STEVENS, CORPORATIONS (1936) § 178; BALLANTINE, CORPORATIONS (1927) § 199.

[14] Handley v. Stutz, 139 U. S. 417 (1891); Coit v. Amalgamating Co., 119 U. S. 343 (1886); First Nat. Bank v. Gustin M. C. Min. Co., 42 Minn. 327, 44 N. W. 198 (1890); BALLANTINE, CORPORATIONS (1927) § 212.

[15] Chandler v. Miller, 172 Wash. 252, 19 P. (2d) 1108 (1933); Atwood v. McKenzie-Waterhouse Co., *supra* note 6; Walton Lbr. Co. v. Commonwealth Lbr. Co., 95 Wash. 295, 163 Pac. 762 (1917).

[16] Cooney v. Arlington Hotel, 11 Del. Ch. 286, 101 Atl. 879 (1917); Easton Nat. Bank v. American Brick & Tile Co., 70 N. J. Eq. 732, 64 Atl. 917 (1906); BALLANTINE, CORPORATIONS (1927) § 213; STEVENS, CORPORATIONS (1936) §§ 178-179; Note (1935) 33 MICH. L. REV. 1059.

[17] *Cf.* Lantz v. Moeller, *supra* note 5; Davies v. Ball, *supra* note 6; Dunlap v. Rauch, *supra* note 1.

[18] See note 6 *supra*.

[19] 8 Wash 674, 36 Pac. 1089 (1894).

[20] 78 Wash. 602, 139 Pac. 755 (1914)

[21] See note 11 *supra*.

acceptance of bonus stock carries an implied promise to pay for it if it becomes necessary to do so, thus putting liability back on the contract basis along with unpaid subscriptions.

In the absence of express statutory authorization, the creditor's indirect relation to the subscription contract precludes an individual creditor's suit at law to enforce the subscriber's liability for an unpaid amount.[22]

By statute or judicial decision, a creditor's bill in equity after an unsatisfied judgment[23] against the corporation has been established as the normal device for the collection of this asset.[24] Most courts hold that a creditor's bill, while it need not make all creditors actual parties, must be brought on behalf of all who may come in, on the ground that when the corporation is insolvent, the equity court looks on all assets as a trust fund for all creditors, and no one creditor may go into equity and appropriate such assets exclusively to himself.[25]

Even where the bill is not brought on behalf of all creditors, other creditors have the right to come in and share in the distribution. Where the bill is brought on behalf of all who may wish to come in, other creditors must come into the action if they wish to enforce their claims, for they cannot thereafter bring separate suits.[26]

Because of the defects of individual remedies, and since creditors' resort to unpaid subscriptions is only necessary when the corporate assets are insufficient to meet debts, the collective process is the more desirable procedure to enforce a creditor's right to satisfaction from unpaid subscriptions. The Washington court holds that a proceeding in equity by a receiver against all unpaid shareholders is the proper method of relief for complaining creditors.[27] Under the common form of remedial statute obtaining in Washington,[28] any creditor (not

[22] Montesano v. Carr, 80 Wash. 384, 141 Pac. 894 (1914); Burch v. Taylor, 1 Wash. 245, 24 Pac. 438 (1890); Patterson v. Lynde, *supra* note 6; First Nat. Bank v. Peavy, 69 Fed. 455 (C. C. N. D. Ia, 1895); Beach v. Beach Hotel Corp., 117 Conn. 445, 168 Atl. 785 (1933).

[23] Chamberlain v. Piercy, *supra* note 2; Lantz v. Moeller, *supra* note 5; New York Nat. Exchange Bank v. Metropolitan Sav. Bank, 28 Wash. 553, 68 Pac. 905 (1902); Adamant Mfg. Co. v. Wallace, *supra* note 1.

[24] It is not necessary first to obtain a judgment against the corporation when it is otherwise shown that such a proceeding would be utterly futile. Chilberg v. Siebenbaum, 41 Wash. 663, 84 Pac. 598 (1906). Insolvency of the corporation itself justifies a creditor's suit, without first getting a judgment. Peeples v. Hayes, 4 Wn. (2d) 253, 104 P. (2d) 303 (1940).

[25] Montesano v. Carr, *supra* note 24; BALLANTINE, CORPORATIONS (1927) § 200.

[26] FLETCHER, CYCLOPEDIA OF CORPPORATIONS (3rd ed. 1932) §§ 6201, 6537.

[27] Montesano v. Carr, *supra* note 22; Cox v. Dickie, *supra*, note 6; Mitchell v. Jordan, 36 Wash. 645, 79 Pac. 311 (1905); New York Nat Exchange Bank v. Metropolitan Savings Bank, *supra* note 23; Elderkin v. Peterson, 8 Wash. 674, 36 Pac. 1089 (1894); Wilson v. Book, 13 Wash. 676, 43 Pac. 939 (1876).

[28] WASH. LAWS 1937, c. 47, § 1; REM. REV. STAT. (Supp. 1937) § 741: "A receiver may be appointed by the court in the following cases: . . . 5. When a corporation has been dissolved or is in the process of dissolution or is insolvent, or is in imminent danger of insolvency, or has forfeited its corporate rights, and when the court in its sound discretion deems the appointment of a receiver is necessary to secure ample justice to the parties; . . ."

only a judgment creditor)[29] may, on the insolvency of a corporation, procure the judicial appointment of a receiver, who thereupon becomes invested with the rights and title of the corporation[30] for the purpose of collecting assets for the benefit of all assenting creditors, and who can compel payment of unpaid subscriptions to the extent necessary to satisfy creditors.[31]

There are two divergent methods of procedure by a receiver, depending on the statutory provisions and equitable practice of the particular jurisdiction.

(1) The theory that the receiver is entitled to collect the unpaid subscription price as any other corporate obligation in order to marshal assets upholds the power of the receiver to proceed at law or equity against all of the delinquent subscribers without a judicial ascertainment of existing debts. On the collection of all available assets, equitable adjustment of the rights of creditors and shareholders is made by the appointing court.[32]

(2) Because of legislative and judicial emphasis on the proportionate liability of subscribers to creditors on corporate insolvency, before a receiver's recovery of this type of asset, it is necessary to have a judicial determination of the extent of the subscriber's proportionate liability. Mechanically this is fixed by means of an assessment proceeding instituted in the appointing court by the receiver to compute the amount of the debts and available assets of the corporation, and to levy a pro rata assessment on delinquent subscribers to the extent necessary to satisfy outstanding claims.[33]

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[29] It is the insolvency of the corporation that constitutes the ground for receivership, and no other condition. Kreide v. Independence League of America, 188 Wash. 376, 62 P. (2d) 1101 (1936); Snyder v. Yakima Finance Corp., 174 Wash. 499, 25 P. (2d) 108 (1933); Smith v. Solomon Valley Dredging Co., *supra* note 3; Blum v. Rowe, 98 Wash. 683, 168 Pac. 781 (1917); Davis v. Edwards, 41 Wash. 480, 84 Pac. 22 (1906); Oleson v. Bank of Tacoma, 15 Wash. 148, 45 Pac. 734 (1896). A receiver cannot be appointed to collect unpaid subscriptions where the corporation is solvent. Bergman Clay Mfg. Co. v. Bergman, 73 Wash. 144, 131 Pac. 485 (1913).

[30] The receiver can have no greater right than the corporation would have had, unless it is affirmatively shown that rights of creditors existing at the time were prejudiced thereby, Murphy v. Panton, *supra* note 6; Walton Lumber Co. v. Commonwealth Lumber Co., *supra* note 15.

[31] Republic Iron & Steel Co. v. Carlton, 189 Fed. 126 (C. C. D. Md. 1911); Van Arsdale v Richards, 247 Ky. 77, 56 S. W. (2d) 728 (1933); Geigy Co. v. Wilfling, 50 R. I. 506, 149 Atl. 609 (1930).

[32] Hundley v. Hewitt, 195 Ala. 647, 71 So. 419 (1916); Cosmopolitan Life Ins. Co. v. Sheats, 20 Ga. Ap. 622, 93 S. E. 507 (1917); Graves v. Denny, 15 Ga. Ap. 718, 84 S. E. 187 (1915); Meholin v. Carlson, 17 Idaho 742, 107 Pac. 755 (1910); Preston v. Jeffers, 179 Ky. 384, 200 S. W. 654 (1918); Bank of Kaplan v Richards, 165 La. 659, 115 So. 815 (1928); Jackson Fire & Marine Ins. Co. v. Walle, 105 La. 89, 29 So. 503 (1900); Guilbert v. Hessinger, 173 Mo. Ap. 680, 160 S. W. 17 (1913); Pope v. Merchant's Trust J. P. Co., 118 Tenn. 506, 103 S. W. 792 (1907).

[33] Guaranty Trust Co. v. Satterwhite, *supra* note 11; Johnson v. Pheasant Pickling Co., 174 Wash. 236, 24 P. (2d) 628 (1933); Connor v. Robinson, 137 Wash. 672, 246 Pac. 758 (1926); Rea v. Eslick, 87 Wash. 125, 151 Pac. 256 (1915); Chamberlain v. Piercy, *supra* note 2; Beddow v. Huston, 65 Wash. 585, 118 Pac. 752 (1911); Shuey v. Adair, 24 Wash. 378, 64 Pac. 536 (1901); *In re* Bass, 215 Fed. 275 (N. D. Ga., 1914); Rosoff v. Gilbert Transportation Co., 204 Fed. 349 (D. Conn, 1913); Fletcher v. Bank of Lonoke,

Washington follows this second view, but the efficiency of this procedure is sometimes questionable. There is always the possibility that, through the insolvency or other disability of one or more of the shareholders, it might be impossible to collect the full assessment. This would necessitate the receiver's bringing successive actions to recover the amount actually necessary to offset the corporate liabilities. In view of the language of the court in *Gaunce v. Schoder*,[34] it is at least arguable that a receiver has no authority to make an assessment call, and that by suit for a portion of his entire claim against a shareholder, his right to recover the whole amount has been adjudicated, with the result that he has no right to maintain successive actions. On the other hand, if the first view were followed and all delinquents were joined and recovery of the full amount unpaid were permitted, the receiver could pay the corporate debts and redistribute the excess to the shareholders in an equitable manner, avoiding these difficulties.

After an appointment of a receiver, creditors, singly or in a group, may not themselves sue shareholders.[35]

For a complaint against an unpaid shareholder to state a cause of action in Washington, there must be allegations (1) as to the value of the assets of the corporation; (2) that defendant shareholders had notice or an opportunity to be heard on validity of claims against the insolvent corporation; (3) that the court, after notice to shareholders, had determined what proportion of each shareholder's subscription remaining unpaid was necessary to meet the valid obligations of the corporations after the assets had been exhausted; (4) that after this finding, the court had directed that proceedings be instituted against all such shareholders.[36]

The proceedings in receivership in which assessments are levied are conclusive as against shareholders as a determination of the total amount of the financial necessities of the receivership and the authority of the receiver to sue is definitely established thereby, but it is not conclusive as to the amounts for which each shareholder is personally liable on his alleged unpaid subscription.[37]

The weight of authority is to the effect that creditor's suits may be brought against one or more shareholders without making all shareholders parties even though others are also liable. The corporation itself is a necessary but not an indispensable party. Objection to nonjoinder is waived if not made by demurrer or answer.[38]

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71 Ark. 1, 69 S. W. 580 (1902); Dupont v. Ball, 11 Del. Ch. 430, 106 Atl. 39 (1918); Cumberland Lbr. Co. v. Clinton Hill Lbr. Mfg. Co., 57 N. J. Eq. 627, 42 Atl. 585 (1899); Cook v. Carpenter, 212 Pa. 165, 61 Atl. 799 (1905).

[34] *Supra* note 4.

[35] Guaranty Trust Co. v. Satterwhite, *supra* note 11; Shuey v. Adair, *supra* note 33; Watterson v. Masterson, 15 Wash. 511, 46 Pac. 1041 (1896).

[36] Guaranty Trust Co. v. Satterwhite, *supra* note 11; Hosner v. Conservative Casualty Co., *supra* note 6; Silvain v. Benson, 83 Wash. 271, 145 Pac. 175 (1915); Gordon v. Cummings, *supra* note 5; Grady v. Graham, 64 Wash. 436, 116 Pac. 1098 (1911); Johnson v. Pheasant Pickling Co., Rea v. Eslick, Beddow v. Huston, all *supra* note 33.

[37] Guaranty Trust Co. v. Satterwhite, *supra* note 11; Silvain v. Benson, *supra* note 36; Bennett v. Thorne, 36 Wash. 253, 78 Pac. 936, 68 A. L. R. 113 (1904); Johnson v. Pheasant Pickling Co., Connor v. Robinson, Rea v. Eslick, Shuey v. Adair, all *supra* note 33.

[38] BALLANTINE, CORPORATIONS (1927) § 200; Note (1935) 33 MICH. L. REV. 1059.

Early Washington decisions permitted recovery by a receiver against any one of the shareholders to the full amount of his unpaid subscription, providing the receiver gave notice of the assessment call before bringing action.[39] Later cases have developed a rule requiring all delinquent shareholders to be joined and allowing recovery only on a pro rata basis.[40]

An actual subscription is not always necessary in order to establish one as a shareholder. Any agreement by which a person shows an intention to become a shareholder is sufficient to bind both him and the corporation. When one accepts or assumes the position and duties, and claims the rights, privileges and emoluments of a shareholder, and the corporation accepts and acquiesces therein, such person is estopped to deny that he is a subscriber, even though there may have been something irregular or defective in the form or manner of his subscription or there may have been no formal subscription at all.[41] Holders of unpaid stock cannot defeat an action for the balance due by claiming that they hold such stock as a mere gratuity.[42] Nor is it a defense that the subscriber was misled and bought his stock believing that it was fully paid and nonassessable.[43] As between the corporation and the shareholders, defenses of fraud, misrepresentation inducing subscription, lack of full subscription to stock and organization defects are probably good, but as between shareholders and creditors, another rule applies,[44] and such defenses are not recognized.

In the case of "watered" stock, the basis of the right to collect is that credit was given in reliance on the presumption that full par value has been received by the corporation for the stock which it issued as fully paid. The majority rule is that where it appears that a particular creditor, at the time credit was given, knew of the difference between the par value of the stock and the value of the property received for it, there is no reliance and no deception.[45] Most cases put the burden on creditors to allege and prove that they had no knowledge that the stock was issued at an excessive valuation.[46]

As to merely unpaid stock, we have seen that the theory of recovery is based on the equitable attachment of corporate assets, while in the

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[39] Cox v. Dickie, *supra* note 6; Elderkin v. Peterson, *supra* note 19.

[40] Johnson v. Pheasant Pickling Co., Connor v. Robinson, both *supra* note 33; Gaunce v. Schoder, *supra* note 4; Note (1933) 8 WASH. L. REV. 89.

[41] Davies v. Ball, *supra* note 6; Wright v. Lewis, 161 Md. 674, 158 Atl. 704 (1932).

[42] Gordon v. Cummings, *supra* note 5.

[43] Cox v. Dickie, *supra* note 6.

[44] Flury v. Twin Cities Dairy Co., 136 Wash. 462, 240 Pac. 900 (1925); Silvain v. Benson, *supra* note 36; Gordon v. Cummings, *supra* note 5; Nat. Realty Co. v. Neilson, 73 Wash. 89, 131 Pac. 446 (1913); Cox v. Dickie, *supra* note 6; Cole v. Satsop Ry. Co., 9 Wash. 487, 37 Pac 700 (1894); Note (1935) 33 MICH. L. REV. 1059.

[45] Davies v. Ball, *supra* note 6; Turner v. Bailey, 12 Wash. 634, 42 Pac. 115 (1895); Sherman v. S. K. D. Oil Co., 185 Cal. 534, 197 Pac. 799 (1921); Watt v. German Savings Bank, 183 Ia. 346, 165 N. W. 897 (1917); Collier v. Edwards, 144 Okla. 69, 289 Pac. 260 (1930).

[46] Gaunce v. Schoder, *supra* note 4; Chamberlain v. Piercy, *supra* note 2; Inland Nursery & Floral Co. v. Rice, 57 Wash. 67, 106 Pac. 499 (1910); Johnson v. Pheasant Pickling Co., Connor v. Robinson, both *supra* note 33.

case of "watered" stock, the fraud theory is still followed by the majority, but the statutory obligation doctrine is attracting increasing attention. Although an individual creditor may still bring a bill in equity against any of the unpaid shareholders in behalf of all creditors similarly situated, the accepted practice in Washington today is to have a receiver appointed to bring suit for each stockholder's proportionate share of the corporate indebtedness.

JANE SUE ABERNETHY.

TORT LIABILITY OF CHARITABLE CORPORATIONS

The protective and friendly attitude with which the courts and legislatures have viewed charities is reflected in the rule of non-liability for torts committed by such eleemosynary institutions.[1] The rationales for this exemption may be briefly classified into five main groups. The first and most all inclusive is the trust fund doctrine based on an early English case and exemplified by the Massachusetts decisions.[2] Under this theory a charitable institution can not be held liable for the negligence of servants and employees or administrative officials.[3] Nor is the court concerned with the status of the plaintiff as beneficiary, employee or stranger.[4] The trust fund can not be diverted from the charitable purposes for which it was intended to compensate for one injured in the execution of these duties.

The non-applicability of the rule of *respondeat superior* is also suggested as a basis for the freedom from liability.[5] The public policy behind the usual application of the rule is felt to be lacking in this situation since the master does not profit by the employment of the servant. An interesting variation of this rule is suggested by the New York court which held that the master servant relationship, itself, did not exist between the hospital and its doctors, internes, or nurses.[6]

[1] This same attitude is reflected in the tax statute granting exemptions to charities. WASH. LAWS 1939, c. 206 § 8; REM. REV. STAT. (Supp. 1939) § 1111. Also see the Unemployment Compensation Act, WASH. LAWS 1937, c. 162 § 19; REM. REV. STAT. (Supp. 1939) § 9908-119, and Virginia Mason Hospital Association v. Larson, 109 Wash. Dec. 323, 114 P. (2d) 976 (1941), interpreting it.

[2] Heriot's Hospital v. Ross was cited by the Massachusetts court as authority for granting immunity. McDonald v. Massachusetts General Hospital, 120 Mass. 432, 21 Am. Rep. 529 (1876). The true interpretation of this early English case has been the basis of much discussion. See Tucker v. Mobile Infirmary Ass'n., 191 Ala. 572, 68 So. 4 (1915).

[3] Kidd v. Massachusetts Homeopathic Hospital, 237 Mass. 500, 130 N. E. 55 (1921); Rosen v. Peter Bent Brigham Hospital, 235 Mass. 66, 126 N. E. 392 (1920).

[4] Emery v. Jewish Hospital Ass'n., 193 Ky. 400, 236 S. W. 577 (1921) (injury to servant); Loeffler v. Trustees of Sheppard & Enoch Pratt Hospital, 130 Md. 265, 100 Atl. 301 (1917) (injury to stranger); Reavey v. Guild of St. Agnes, 248 Mass. 316, 187 N. E. 557 (1933) (injury to servant); Foley v. Wesson Memorial Hospital, 246 Mass. 363, 141 N. E. 113 (1923) (stranger injured by negligence of ambulance driver).

[5] Southern Methodist Hospital & Sanatorium v. Wilson, 45 Ariz. 507, 46 P. (2d) 118 (1935); Hearns v. Waterbury Hospital, 66 Conn. 98, 33 Atl. 595 (1895).

[6] Phillips v. Buffalo General Hospital, 239 N. Y. 188, 146 N. E. 199 (1924); In Matter of Bernstein v. Beth Israel Hospital, 236 N. Y. 268, 140 N. E. 694 (1923).