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SHAREHOLDERS' LIABILITY FOR DIVIDENDS IMPROPERLY DECLARED AND PAID

ALTHOUGH the conduct of corporations is governed to a considerable extent by statute in practically every state, this fact does not render inappropriate at least cursory consideration of the common-law background of even those aspects of corporate finance which have received legislative consideration. As both the common-law and history play in this connection at least an interstitial role on the legal stage of today, these will provide a point of departure for a consideration of certain problems arising out of the act of a corporation in paying an illegal dividend to its shareholders, the amount of which creditors subsequently attempt to recover.

Just as according to almost any notion of substantial justice the aggrieved creditors would seem entitled to recover, so provision therefor was made in the earliest English charters to the effect that liability should fall on the shareholders.[1] However, a search for a body of early common-law precedents on the point would be in vain, for the earliest cases involving dividends did not litigate the actual validity of their declaration but rather were suits between parties each claiming the dividends.[2]

The path which this particular phase of dividend law was to follow in the American jurisdictions was hewed largely by historical accident. In this country the special charter and general incorporation acts have been the principal device for regulation of such corporate acts rather than a large volume of case law. Personal liability for illegal dividends was imposed on the directors so declaring, rather than on the shareholders receiving, in

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[1] Amendments to Charter of Bank of England, 8 and 9 WM. AND M., 1697, c. 20; Act authorizing charter of English Linen Company, 4 GEO. III, 1764, c. 37.

[2] Johnson v. East India Co., Finch Ch. 430 (Ch. 1679); Gardner v. Pullen & Phillips, 2 Vern. 394 (Ch. 1700).

the first American charters[3] and in the basic New York Act of 1825, which in turn were patterned after a clause imposing such liability in the first charter of the Bank of the United States.[4] This latter clause had itself been taken from the 1694 Act authorizing the Crown to charter the Bank of England;[5] but in the copying, Alexander Hamilton, by substituting directors' liability for that of the shareholders, shifted statutory liability from the shareholder to the directors who declared the dividend.[6] However, this approach has been eroded by considerations of business expediency so that now the shareholder is also responsible for illegal dividends, a responsibility determined by a group of factors often vague and uncertain.[7]

The initial inquiry in any attempt to evaluate the wisdom of such a result must be as to the *source* of an improper dividend. Ordinarily it is said to be one declared out of capital stock, meaning by the latter term the assets contributed by shareholders which afford the basis for credit advanced by the creditors. Ballantine[8] prefers to call this fund "legal capital" and describes it as a "certain level marked by a gauge upon the corporate reservoir of assets. If the assets stand above that level, they may be drawn off for the shareholder. If the assets fall below that level, the remaining supply must be reserved for business purposes and for the creditors. Capital is 'impaired' . . . if the value of the assets falls below the amount of the liabilities plus the amount of the legal capital. No dividend may lawfully be paid unless after such payment the value of the property of the corporation . . . is equal to the aggregate of its liabilities and the legal capital."

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[3] N. J. Acts 1803, c. 109 (Newark Banking & Ins. Co.); Pa. Acts 1804, c. 51 (Philadelphia Bank).

[4] 1 STAT. 191 (1789) (making directors responsible for incurring corporation debts in excess of the bank's capital).

[5] 5 and 6 WM. AND M. 1692, c. 20.

[6] KEHL, CORPORATE DIVIDENDS (1941) c. 1.

[7] COOK, CORPORATIONS (8th ed. 1923) § 548.

[8] Ballantine and Hills, *Corporate Capital and Dividend Restrictions* (1935) 23 CALIF. L. REV. 229.

For whose benefit are these directions against depletion of capital, capital stock, or legal capital, as the fund is variously designated? According to one view, the fund is for the benefit of the shareholders; under this view there can be a recovery of dividends only when the corporation is actually insolvent at the time of payment. The other view, of course, is that the fund is for the protection of creditors; by this approach a recovery is always permitted when the payment of a dividend impairs capital. But under either view the contested dividend must have been actually illegal before recovery is permitted; that it was merely ill-advised in the light of subsequent events as a declaration by prodigal directors will not support an action forcing the shareholder to disgorge.

Theories of Liability

Trust Fund Theory. The anachronistic citadel upon which shareholder liability has been predicated has been the trust fund theory. Its thesis is that the capital of a corporation is a fund pledged for the payment of its debts. Each person who gives credit to the corporation does so with the confidence that the fund exists for his protection and security against loss. The shareholders are deemed to be conclusively charged with notice of the trust character which attaches to the capital stock. As to it, they cannot occupy the status of innocent purchasers; and when they have in their hands any of this fund, they hold it *cum onere*, subject to all equities which attach to it. This may savor of a creditor's idea of equity, but it is not sound law.

The Supreme Court of the United States, as well as most of the highest state courts, has had occasion to consider and to deny the soundness of this doctrine.[9] Such a result has not been surprising since only the statement of the doctrine is required to manifest

[9] Hollins v. Brierfield Coal & Iron Co., 150 U. S. 371 (1893) (overruling Wood v. Dummer, 3 Mason C. C. R. 309 (1824), and declaring that the property of corporations was as fully within their control as that of an individual and could only be converted into a trust fund by actual insolvency).

its incongruity; the term itself is a misnomer as there is neither trustee nor a *cestui que trust* in the strict sense.[10]

In spite of the lack of sound basis for the trust fund theory, and notwithstanding its cogent repudiation, the courts continue to refer to it in judicial opinions as a vital and controlling doctrine.[11] Nor have the Texas courts been free from this error, even though the theory is not essential to the decision reached and the result could have been predicated on firmer ground. Thus the practice of courts refusing to traffic in fresh ideas when they have decided to protect a creditor of a corporation has been to brand the source of the dividend payment a "trust" which *ipso facto* may be recovered from one who is a mere donee and into whose hands the property may be traced.[12] The Maryland court has based the right of recovery on the ground that money paid after insolvency is taken from a fund held in trust for creditors.[13] But the tyranny of labels should not lead to such a conclusion.

Fraudulent Conveyance Theory. The theory most generally seen in recent opinions is that of a fraudulent conveyance. Since a dividend indicates that a corporation is prosperous, it is fraud to pay such from capital stock and thus equity will demand a return. A distribution of assets leaving corporate creditors unpaid is a fraud upon subsisting creditors. This view has been extended to the point of holding the shareholders themselves responsible on the theory that when they invested in the corporation and selected the officers, they thereby guaranteed compliance with the law so that they are equally responsible with directors for fraudulent impairment of capital, especially when they have profited to the extent of the impairment.[14]

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[10] See Hunt, *The Trust Fund Theory* (1902) 12 YALE L. J. 63; (1908) 8 COL. L. REV. 303; (1916) 4 VA. L. REV. 131.

[11] STEVENS, CORPORATIONS (1936) 403.

[12] Arnold v. Knapp, 75 W. Va. 804, 84 S. E. 895 (1915).

[13] Bartlett v. Smith, 162 Md. 478, 160 Atl. 440, 161 Atl. 509 (1932). See Barrows, *The Equitable Liability of Stockholders* (1903) 13 YALE L. J. 66.

[14] See 81 CENT. L. J. 227 (1915); see Cottrell v. Albany Mfg. Co., 142 App. Div. 148, 126 N. Y. Supp. 1070 (1911).

Reference should be made in this connection to the Uniform Fraudulent Conveyance Act. A literal interpretation of Section 5 of the Act[15] might well be relied upon by the creditors, even though the corporation was solvent at the time of payment. Yet there seems to be no case in which the plaintiff has taken advantage of this possibility.[16] However, in at least one case in Massachusetts,[17] recovery was allowed of a dividend paid when the corporation was insolvent, the court saying that any doubt as to the right to recover dividends paid by an insolvent corporation had been removed by the enactment of the Uniform Act. Even as an original question it would seem that a corporation should be subject to the same restrictions against fraudulent conveyances of its property as an individual. Perhaps the argument may be made thus: when an insolvent man is suddenly influenced by a transient feeling of gratitude and becomes generous with his assets, the resulting conveyance is fraudulent as a matter of law, and the donee must surrender. Simply because the debtor happens to be a corporation to whom a few more devices are available, it should not be allowed to make fraudulent conveyances. Furthermore, it is a reasonable assumption that the provisions in the various corporation acts are intended to be additional safeguards and are not effective to suspend restrictions which exist as to all other persons.[18] Certainly if the corporation is insolvent and pays an illegal dividend to its shareholders, the theory of fraudulent conveyance is a sufficient basis for the suit.[19] Many states have general fraudulent conveyance statutes prohibiting the transfer of property by insolvent debtors. And in several of the

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[15] The provision of the Act is as follows: "Every conveyance made without fair consideration when the person making it is engaged . . . in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors. . . ."

[16] Weiner, *Theory of Anglo-American Dividend Law* (1929) 29 Col. L. Rev. 462.

[17] Powers v. Heggie, 268 Mass. 233, 167 N. E. 314 (1929).

[18] Kehl, note 6 *supra*.

[19] See (1933) 33 Col. L. Rev. 481.

leading corporation states, the Uniform Fraudulent Conveyance Act has been adopted.[20]

Calling an improper dividend a fraudulent conveyance has an appeal to the complacent, but it is not an answer to the issues actually presented. Ingenious criticism has been directed at this theory.[21] In the first place the shareholder is not a naked donee as is the usual conveyee in a fraudulent transfer, for the simple reason that he has made an investment in the enterprise. Furthermore, once the corporation declares a dividend, such declaration assumes the status of a debt to the shareholder and becomes due and payable as such. Were this merely a promise of a gift, no such result would follow.

Statutory Liability. A third basis for shareholder liability is provided in statutory regulation. Statutes exist in most states forbidding payment of dividends out of capital. In some states the limitation is express, but in any state it is difficult to assert a construction that denies the implication in the statutes against improper payment of dividends. Thus a third ground is available for holding that any such payment is illegal and may be set aside by any interested party. A shareholder profiting by such action must give up what he has illegally received.

The strictest type of statute is that which imposes liability under any circumstances so long as the shareholder has received a dividend paid out of funds other than profit or surplus[22] and makes the shareholder liable to any creditor for the amount of capital refunded to him.[23] Within this category of strict provisions should also be included those statutes which make the shareholder liable not only to the creditors, but also to the directors who have

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[20] DEL. REV. CODE (1935) §§ 6059-6070; MD. ANN. CODE (Bagby, 1924) art. 39B; MASS. LAWS ANN. (1932), c. 109A, §§ 1-12; MICH. STAT. ANN. (1936) §§ 26.881-26.894; MINN. STAT. (Mason, 1927) §§ 8475-8489; N. J. REV. STAT. (1937) § 25:2-7, 25:2-19; PA. STAT. ANN. (Purdon, 1930) §§ 351-63.

[21] See 2 GLENN, FRAUDULENT CONVEYANCES (rev. ed. 1940) § 604.

[22] R. I. GEN. LAWS (1923), c. 248, § 38.

[23] MICH. COMP. LAWS (1929), § 10018.

incurred loss for the wrongful declaration.[24] Maine requires a judgment against the corporation as a condition precedent to recovery against the shareholder.[25] A provision of the strict type is found in the Uniform Business Corporation Act, Section 25.[26]

The element of scienter is characteristic of another general classification of the statutes regulating shareholder liability. This type of statute adds the word "knowledge," thus making good or bad faith the decisive factor in the controversy. The California statute, for example, provides that "any stockholder . . . who receives any dividend not authorized . . . with knowledge of facts indicating the impropriety thereof shall be liable . . . for the amount so received. . . ."[27] In interpreting this statute the California court has held that "dividend not authorized" covers any division of profits or capital of a corporation not made in accordance with the corporation law of the state and included distribution of capital between stockholders who informally agreed thereto.[28] However, Ohio, while making bad faith a condition precedent, limits liability "to the corporation."[29]

It was long contended in those jurisdictions making the directors liable by statute that had the legislature intended to make the shareholders liable, it would have specifically referred to them. But the courts have indicated that shareholder liability exists irrespective of the statute;[30] that the statute does not transfer liability from the shareholder to the directors, but creates a cumula-

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[24] W. VA. CODE ANN. (Barnes, 1923) c. 31, art. 1.

[25] ME. REV. STAT. (1930) c. 56, § 102. See VT. GEN. LAWS (1917) § 4940; WIS. STAT. (1929) § 182.19.

[26] The section reads: "Every stockholder who received any such dividend ... shall in the following instances be ... liable to the corporation ... (a) when no director is liable to the corporation ..., or (b) to the extent that the corporation is unable to obtain satisfaction after judgments recovered against directors. . . ."

[27] CALIF. CIV. CODE (Deering, 1931) § 364.

[28] Oilwell Chemical & Materials Co. v. Petroleum Supply Co., 64 Cal. App. 367, 148 P (2d) 720 (1944).

[29] OHIO GEN. CODE (Deering, 1931) § 364; see Idaho Laws 1929, c. 262, p. 561; La. Laws 1928, Act 250, p. 27.

[30] Bottlers Seal Co. v. Rainey, 243 N. Y. 333, 153 N. E. 437 (1926).

tive liability in favor of the corporation and creditors.[31] This ghost seems to have been laid by the decisions of those courts in whose jurisdiction the shareholders are specifically mentioned by statute when they say the same result would have been forthcoming irrespective of the statute.

To what extent has the creditor received protection? Once liquidation has begun, the liquidator of course represents all creditors; but even if there is no liquidation in progress, a judgment creditor of a corporation may sue the shareholders in equity. In this type of suit the creditor may act for himself and need not champion a representative suit.[32] And the Supreme Court of Maryland held that the judgment creditor need not sue in equity, but can maintain a quasi-contractual action for money had and received.[33]

Misrepresentation of Fact. A theory akin to fraudulent conveyance, but not squarely within its purview, is that of misrepresentation of fact. The distinction is discernible but not obvious. Corporations operate by means of their capital fund. Thus a misrepresentation of fact occurs when this fund is represented to be greater than it really is. Therefore for a debtor corporation to appear to be in command of greater resources than are actually at its disposal is misleading. The basis for recovery here is that credit was extended in reliance on a misrepresentation. Of course the creditor must show credit was extended prior to termination of the misleading appearance of greater resources. Any actual knowledge will preclude recovery.[34]

Mistake. A final theory which should at least be adverted to is that of mistake. Although this theory has never enjoyed wide acceptance, recovery has been permitted in Kentucky on the grounds that a payment of dividends made under mistake should

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[31] Williams v. Boice, 38 N. J. Eq. 364 (1884).
[32] Hatch v. Dana, 101 U. S. 205 (1879).
[33] GLENN, note 21 *supra*.
[34] (1938) 47 YALE L. J. 1164.

in good conscience be repaid.[35] A later case in the same jurisdiction was decided on the ground of "mutual mistake" between corporation and shareholders which was held not to have been ratified by receipt of an illegal dividend declared by the directors.[36] This idea apparently has only been mentioned in passing in other cases.[37]

EFFECT OF INSOLVENCY OF THE CORPORATION

Two factors must now be considered which are operative in every controversy over illegal dividends: first, the financial status of the corporation, *i.e.*, whether it is solvent or insolvent; second, the faith of the shareholder, whether good or bad. To recognize these considerations is obviously to weigh the conflicting interests of shareholder and creditor, and the solution will lie, if solution there be, in an arena in which these two economic policies compete for supremacy.

Needless to say, there is more than one method of appraising a corporation's financial standing to determine insolvency. The two basic tests which have ordinarily been employed have been the equity test of ability to meet obligations as they mature and the bankruptcy test of excess of assets over liabilities, exclusive of capital. Generally, statutory provisions are applicable and determine the test to be applied.

When the corporation is solvent, both at the time of payment of the dividend and at the time of suit, there is conflict as to the liability of the shareholder for receipt of an improper dividend. The rule applied by most of the states[38] is that a shareholder who in good faith receives illegal dividends from a solvent corporation cannot be held liable to refund them even though they are paid out of capital stock. This view of course is a logical exten-

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[35] Gratz v. Redd, 4 B. Mon. 178 (Ky. 1843).

[36] Lexington L. F. & M. Ins. Co. v. Page & Richardson, 17 B. Mon. 412 (Ky. 1856).

[37] Salina Mercantile Co. v. Stiefel, 82 Kan. 7, 107 Pac. 774 (1910); Lords Equity Exchange v. Jones, 42 N. D. 145, 145 N. W. 863 (1919).

[38] Carlisle v. Ottley, 143 Ga. 797, 85 S. E. 1010 (1915).

sion of the view which rejects the trust fund doctrine, the idea being that there is no lien of creditors upon a solvent concern. Instead, this result is based on the principle that a corporation, while solvent and a going concern, holds its property, as does an individual, free from the control of its general creditors and may dispose of it as it deems best, subject to the provisions of its charter and those other restraints upon the conveyance of property which the law imposes alike upon corporation and individual.

In a number of states shareholders are held liable to refund dividends illegally paid even though the corporation was solvent at the time of payment and at the time of suit. Nor does it matter according to this view that the shareholder may have received the dividend in ignorance of the true state of affairs.[39] Under this view the payment of dividends from capital is in all cases a voluntary disposition of assets which impairs the capital and is forbidden as a fraud on creditors, or as a dissipation of the trust fund, or as misappropriation of a fund pledged for the payment of debts; the courts hold that the fund may be followed into the hands of shareholders who are not to be considered bona fide purchasers. Such theories are of out-dated concern. For surely it is fallacious to say that a creditor is injured by a payment of dividends made out of capital so long as assets enough are left to pay all the debts. The doctrine laid down in *McDonald v. Williams*[40] and in the cases which follow it[41] seems to be an exception to the general principle of the law of restitution that a non-tortious taker of property which it would have been wrongful to take had he known the facts, is under a duty to account, provided no value has been paid.[42] There is no paucity of doctrines available for proceeding against the innocent shareholder and his

39 Mackall v. Pocock, 136 Minn. 8, 161 N. W. 228 (1917).

40 McDonald v. Williams, 174 U. S. 397 (1898).

41 Burton v. Roos, 20 F. Supp. 75 (S. D. Tex. 1937) (ordinarily a stockholder is not liable for the debts of his company because of a dividend declared and paid to him, nor required to pay back a dividend paid to him where the dividend is providently and in good faith declared and paid).

42 RESTATEMENT, RESTITUTION (1936) § 123.

dividend impecuniously born. Why then do many courts refuse to do so? Perhaps it is because of a seeming tendency to lessen emphasis upon protection to the creditor. When the corporation was a new form of organization, insolvency often came quickly. Safeguards for the creditor were necessary. However, there is reason to believe that this concern is somewhat less important to the courts now that state statutes everywhere control the activities of corporations, the Securities and Exchange Commission has become a silent director, and economic responsibility has become a *fait accompli.*

On the other hand it is clear that dividends paid out of capital at a time when the corporation was insolvent may be recovered back.[43] For when actual insolvency arises, the creditor can surely claim injury, and the dividend is recoverable from all shareholders, innocent and guilty. In many states, statutes provide that insolvency dividends shall not be paid. The statutory prototype of some modern enactments appeared first in the manufacturing corporation regulation act adopted by Massachusetts in 1830.[44]

In a large number of states the insolvency restriction is descended from the original Massachusetts law through the New York Manufacturing Act of 1848, which contained a provision making directors liable for improper dividends.[45] Thus was created the anomalous hybrid of the Massachusetts insolvency rule and the New York capital impairment doctrine. And this laid a pattern which was widely copied and is still in force in several states.[46]

Iowa has the double insolvency—capital impairment restriction of the New York Act of 1848, but in addition a peculiar clause making shareholders liable to persons sustaining damage

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[43] Hayden v. Thompson, 17 C. C. A. 592, 71 Fed. 60 (C. C. A. 8th, 1895).

[44] Mass. Laws (Jan. Laws 1830) c. 53, § 9.

[45] N. Y. Laws 1848, c. 40, § 13.

[46] COLO. STAT. ANN. (1935) c. 41, § 34; MD. ANN. CODE (1935 Supp.) Art. 23, § 87; MISS. CODE ANN. (1930) § 4139; ORE. CODE ANN. (1930) § 25-219; WYO. REV. STAT. (1931) § 28-131.

from dividends which leave insufficient assets to meet the corporate liabilities.[47]

Language similar to the early Massachusetts and New York Acts has been carried over into many of the modern corporation insolvency provisions. Thus the Illinois Business Corporation Act provides that no dividend shall be paid when the corporation is insolvent or its net assets are less than its stated capital, or when payment of the dividend would produce that effect.[48]

The California Act prohibits dividends when the corporation is insolvent either in the equity or the bankruptcy sense.[49] And if there is reasonable ground for believing that the corporation is unable to satisfy its obligations and liabilities, Ohio does not permit dividends to be paid.[50]

In the majority of states, no specific corporation act provision prohibits a corporation from paying dividends when insolvent. It is important to inquire in these states as to the existence of either general statutory provisions or a common-law doctrine which might render such dividend illegal.[51]

Of course the third situation is where the corporation was solvent at the time dividends were paid, but is insolvent at the time of suit. Again there is conflict as to the right to recover against the receiving shareholder. The answer here depends to some extent upon the view taken by the courts as to the trust fund theory. For recourse against a shareholder is not precluded by the fact that a creditor's demand originates after the dividends have been paid, and if he relies on the capital being as represented, he is entitled to compel a refund.[52] This is held to follow from the trust fund theory which is said to apply with equal force to future as well as present creditors. So under this rule dividends paid while

[47] IOWA CODE (1939) § 8377-8.
[48] 32 ILL. ANN. STAT. (Smith-Hurd, 1935) § 157.41.
[49] CAL. CIV. CODE (Deering, 1937) § 346.
[50] OHIO CODE ANN. (Baldwin, 1938) § 8623-38.
[51] See KEHL, note 6 *supra*.
[52] Mackall v. Pocock, 136 Minn. 8, 161 N. W. 228 (1917).

a corporation is insolvent may be recovered by subsequent creditors.

The other view is that creditors whose claims accrue subsequent to the wrongful payment have no equity in the diverted assets superior to that of the shareholder who received the payment in good faith and cannot recover.[53] This rule is followed even in cases involving such a dividend paid at a time when the corporation was insolvent or was rendered so by the payment.

EFFECT OF SHAREHOLDER'S GOOD FAITH

Every analysis of receipt of improper dividends involves the inquiry: What was the faith of the shareholder—good or bad—in receiving such dividend? The authorities are uncomfortably unpredictable as to the effect of good faith. The distinction is of course immaterial when statutory liability is absolute.[54]

The view which holds shareholders liable for dividends paid to them out of capital even though they acted in good faith and without knowledge that the dividend was actually illegal makes a reliance on trust terms. And the incorporation of this view into statutes has been accomplished in those jurisdictions whose laws[55] recite that there is liability under any circumstance for receipt of an improper dividend.[56]

However the United States Supreme Court has held that the receiver of a national bank cannot recover back a dividend declared and paid out of capital at a time when the bank was solvent and the shareholder acted in good faith.[57] This then is the contrary view which was adopted by the federal courts and applied by them to other types of corporations. And this view was seemingly the animating principle for those state statutes which make

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[53] Montgomery v. Whitehead, 40 Colo. 320, 90 Pac. 509 (1907).

[54] See 12 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1931) § 5422 *et seq.*

[55] MICH. COMP. LAWS (1929) § 10018 (stockholder is liable to any creditor for the amount of capital stock refunded to him). See First National Bank v. Heller Sawdust Co., 240 Mich. 688, 216 N. W. 464 (1927).

[56] *In re* Bay Ridge Inn, 98 F. (2d) 85 (C. C. A. 2d, 1938).

[57] McDonald v. Williams, 174 U. S. 397 (1898).

the good or bad faith of the shareholder the crucial point by adding the word "knowingly" to the statute.[58]

An honest approach to this entire problem requires consideration of both the shareholder and the creditor. Both have contributed to the corporate assets but with different incentives. The view favoring priority of creditors is based on the concept that reliance is made on the stated capitalization to guarantee repayment of the loan. Thus the creditor suffers a defeat of his normal expectation when the shareholder receives a return to which he is not legally entitled and which might impair the security of the creditor's loan.

Shareholders make their contributions in expectation of a share of the profits from the enterprise, or a right to participate in the assets of the corporation upon dissolution. Their rights can rise no higher than those of the corporation and the shareholder is married to its fate. Harsh is the view which would demand contribution from an innocent shareholder receiving his dividend in ignorance of its unlawful payment. The situation was expressed with a good deal of accuracy by the Maryland court in *Bartlett v. Smith:*

> "In these days stocks of corporations are so widely held that it would be practically impossible for stockholders generally to know whether each . . . dividend . . . was earned. Whatever their position may be theoretically, practically they are in no better position than creditors to know the condition of the company, and it would be an unfair and unreasonable burden to require them to pay back, years after they have been spent, dividends received in good faith from a solvent corporation in regular course of business."[59]

Some of the appeal of this argument would be sapped by the statute of limitations requirement[60] of prompt action by the

[58] CALIF. CIV. CODE (Deering, 1931) §364; OHIO GEN. CODE (Page, 1931) § 8623-123b. See Chisnell v. Ozier Co., 140 Ohio St. 355, 44 N. E. (2d) 464 (1942).

[59] Bartlett v. Smith, 162 Md. 478, 160 Atl. 440, 161 Atl. 509 (1932).

[60] Uniform Business Corporation Act, § 25, requires that "no action shall be brought against a . . . stockholder . . . unless brought within two years from the date on which such payment . . . was made. . . ."

creditors. Nor would it involve a grudging concession to common sense to say that the shareholder's visa does not entitle him entrance to the sanctum of control, and his only source of information comes from the corporation officers. The chrysallis of a dividend, then, being a resolution stating that it is properly declared, should a shareholder be disturbed who accepts that dividend in the belief that the resolution states the truth?

In the abstract, these considerations seem too remote and shadowy to shape the course of justice. But it may well be indulging in a cruel fiction to require restitution from a shareholder who had not even that kind of notice required before a purchaser is compelled to submit to an outstanding equity. True the shareholder is not technically a purchaser, but morally there seems slight justification for extending the net of either statute or common-law liability beyond the equitable limits that protect the purchaser of ordinary assets.

Where a shareholder has notice, the considerations are obviously different and justice demands a return. Why should he be permitted this unjust enrichment arising from a clear violation of statute? Good faith is missing on the part of a shareholder who has reason to believe payment was made from a source other than that properly designated for dividends. The distinction was considered by Judge Learned Hand who indicated that while a shareholder in good faith was merely an innocent participant, one in bad faith was an accomplice to its commission.

Once a duty to return the dividend is found, it will not avail the shareholder that the shareholders themselves authorized the directors to make the payment;[61] nor that the credit was made on the stock subscription rather than cash;[62] nor that the return was illegal and therefore void;[63] nor that a statutory right of recovery is available against the directors;[64] nor that he has transferred the

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[61] Lexington L. F. & M. Ins. Co. v. Page & Richardson, 17 B. Mon. 412 (Ky. 1856).
[62] Edwards v. Schillinger, 245 Ill. 231, 91 N. E. 1048 (1910).
[63] Tennant v. Epstein, 356 Ill. 26, 189 N. E. 864 (1934).
[64] Bartlett v. Smith, 162 Md. 478, 160 Atl. 440, 161 Atl. 509 (1932).

stock to another;[65] nor that the corporation acted in good faith in paying the dividend.[66]

And suit may be maintained by the corporation or corporation creditors,[67] receivers,[68] or trustees in bankruptcy.[69] Where capital stock is depleted by the payment of unearned dividends to one class of shareholders, to the injury of another class, any one of the latter class may compel the corporation itself to recover the funds so unlawfully withdrawn.[70]

TEXAS LAW

Apparently unable to avoid use of the alluring phrase "trust fund" the Texas Supreme Court has often decided that the capital assets of a corporation constitute a trust fund, but only when there is insolvency plus a quitting of business.[71] And this has been held despite the fact that in dealing with creditors' rights generally, the Texas courts follow the fraudulent conveyance doctrine.[72] As a result of this adherence to the remnant of a theory now coming generally to be abandoned, the cases permit a shareholder to retain dividends, the payment of which rendered the company insolvent, merely because in Texas the assets of a company do not become a trust fund until the insolvent company ceases to do business.

Since statutory basis exists for the protection of creditors,[73] it is not difficult to conclude that the courts could well abandon reference to the nebulous trust fund doctrine both as being unnecessary to the decision reached and as a doctrine pregnant with future controversy.

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[65] Hurlbut v. Tayler, 62 Wis. 607, 22 N. W. 855 (1885).
[66] Detroit Trust Co. v. Goodrich, 175 Mich. 168, 141 N. W. 882 (1913).
[67] Powers v. Heggie, 268 Mass. 233, 167 N. E. 314 (1929).
[68] Detroit Trust Co. v. Goodrich, 175 Mich. 168, 141 N. W. 882 (1913).
[69] Ulness v. Dunnell, 61 N. D. 95, 237 N. W. 208 (1931).
[70] Detroit Trust Co. v. Goodrich, 175 Mich. 168, 141 N. W. 882 (1913).
[71] Lyons-Thomas Hdw. Co. v. Perry Stove Mfg. Co., 86 Tex. 143, 24 S. W. 16 (1893).
[72] Mathis v. Pridham, 1 Tex. Civ. App. 58, 20 S. W. 1015 (1892).
[73] TEX. PEN. CODE (Vernon, 1925) art. 1033a; TEX. REV. CIV. STAT. (Vernon, 1925) arts. 594, 1329, 1347.

Dean Hildebrand espoused the cause of the creditors to the exclusion of any interest of the shareholders.[74] It is his opinion that in order to afford creditors "necessary protection," recovery should lie against even an innocent shareholder who may have changed his position after receiving the dividend, inasmuch as the dividend was paid him by "mistake" and as "he has paid nothing for it." However, he does concede that the Texas trust fund doctrine is "so much opposed to reason and the authorities that it should not be followed."

CONCLUSION

It is the writer's opinion that legislation should be enacted to afford an additional safeguard to creditors of corporations beyond those provided by law for the creditors of individuals. During the early period of American legal history, there were no safeguards provided by law for the protection of creditors.[75] Nor has there been any single pattern for those that have since come into being including varying theories of common-law liability and equally variant types of statutes. If it is uniformity that is desired, a more unworthy genesis can hardly be imagined. There is nothing except the numbing effect of precedent to prevent the courts from relaxing what is often a mere doctrinaire adherence to these varying theories.

An example of authoritative force and illustrative value is that of statutory regulation of public utility companies. Section 12 (c) of the Public Utilities Holding Companies Act[76] briefly stated provides that it shall be unlawful for any company to declare or pay any dividend in contravention of such rules as the Commission deems necessary to protect the financial integrity of companies, to safeguard the working capital, and to prevent the payment of dividends out of capital or unearned surplus. This wording seems fully capable of providing protection to creditors and sharehold-

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[74] See HILDEBRAND, TEXAS CORPORATIONS (1942) § 491.

[75] WARREN, *Safeguarding the Creditors of Corporations* (1923) 36 HARV. L. REV. 509.

[76] 49 STAT. 823 (1935), 15 U. S. C. A. § 791 (1940). See (1940) 49 YALE L. J. 492.

ers alike. A standard is provided for determination of capital impairment and a basis exists for protecting investors against improper withdrawals, whether they be shareholders or creditors.

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