January 1932

Business Trusts—Bankruptcy—Position of Unit Holders

Follow this and additional works at: https://openscholarship.wustl.edu/law_lawreview

Part of the Bankruptcy Law Commons

Recommended Citation

Business Trusts—Bankruptcy—Position of Unit Holders, 17 St. Louis L. Rev. 363 (1932).
Available at: https://openscholarship.wustl.edu/law_lawreview/vol17/iss4/18

This Comment on Recent Decisions is brought to you for free and open access by the Law School at Washington University Open Scholarship. It has been accepted for inclusion in Washington University Law Review by an authorized administrator of Washington University Open Scholarship. For more information, please contact digital@wumail.wustl.edu.

Although confined to Missouri, the doctrine of equitable adoption seems to work substantial justice. Adoption proceedings have been given a judicial character expressly "for the welfare of the child." R. S. Mo. (1929) sec. 14078; after the adoption relationship has existed for years, a decree of equitable enforcement of a promise to adopt will surely have no harmful effect upon the dignity of the statute. Any other course would allow the heirs of the deceased, who stand in his position, to profit by his wrongdoing at the expense of the child. Such an interpretation of the adoption statute would destroy the rights of the child by applying a statutory provision made expressly for his protection and benefit.

H. J., '34.

**Business Trusts—Bankruptcy—Position of Unit Holders.**—An estoppel to contest the validity of a sale by a trustee in bankruptcy was held to have arisen because the unit holders in a business trust had filed their claims and received dividends as creditors of the bankrupt estate. *Page v. Arkansas Natural Gas Corp.* (C. C. A. 8, 1931) 53 F. (2d) 27. The tacit approval of such a procedure is significant since this is the first case in which a Federal Circuit Court of Appeals has been called upon to consider the proper treatment of such unit holders in bankruptcy proceedings against the business trust. It is true that the opinion also relies upon doctrines of *res judicata* and merger to sustain its result, but on these later points alone the decision of the same Court on a former appeal was exactly opposite. *Page v. Natural Gas & Fuel Co.* (C. C. A. 8, 1929) 35 F. (2d) 462 (remanded by three different judges to determine if there had been laches in bringing this suit).

It is well settled that a business trust may become a bankrupt. Under the earlier law the phrase "unincorporated company" had been held to include such an organization. *In re Associated Trust* (D. C. D. Mass. 1914) 222 F. 1012; *Gallagher v. Hannigan* (C. C. A. 1, 1925) 5 F. (2d) 171; National Bankruptcy Act sec. 4b, 30 Stat. 547 (1898), 11 U. S. C. sec. 22. It could become a voluntary bankrupt as it was a "person" for this purpose. *Matter of Sargent Lumber Co.* (D. C. E. D. Ark. 1923) 287 F. 154.

In 1926 Congress amended the definition of corporation set forth in the first section of the Act so as to include under that head "any business conducted by a trustee, or trustees, wherein beneficial interest or ownership is evidenced by certificate or other written instrument." 44 Stat. (part 2) 662 (1926) 11 U. S. C. sec. 1. In the present case the bankruptcy proceeding was instituted in 1924 and hence was governed by the older law.

In none of the few previous cases dealing with the bankruptcy of these Massachusetts' trusts has the position of the unit holder been seriously
considered. If these organizations are to be classed as "unincorporated companies" or "corporations" it would seem that the unit holder could certainly not be treated more favorably than the share holder of any ordinary company, and there is some dictum to support this view. Gallagher v. Hannigan, supra. But by all the canons of corporate law a stockholder is to be treated in bankruptcy proceedings like a part-owner of the business and not a creditor of it. The cases dealing with business trusts outside of the narrow field of their status in bankruptcy have established the fact that the unit holder is in very many instances a person liable for the debts of the trust rather than the holder of any right as creditor against the trust assets. To determine the nature and extent of this liability, it is necessary in most states to discover whether the particular organization will be treated by the courts as being a partnership or a true trust. The usual test is whether the "trustees" or the unit holders have the ultimate power of control over the affairs of the business. Frost v. Thompson (1914) 219 Mass. 360, 106 N. E. 1009; Wrightington, Unincorporated Associations and Business Trusts (2d ed. 1923) sec. 14; note (1928) 13 St. Louis L. Rev. 208. In some states this is decided upon the basis of the actual facts in the situation. Williams v. Milton (1913) 215 Mass. 1, 102 N. E. 365; Goldwater v. Oltman (1930) 210 Cal. 408, 292 Pac. 624; cf. Crocker v. Malley (1919) 249 U. S. 223. In Missouri and other states the court will look to the letter of the written agreement and disregard all else. Darling v. Buddy (1927) 318 Mo. 784, 1 S. W. (2d) 163; Liquid Carbonic Co. v. Sullivan (1924) 103 Okla. 78, 229 Pac. 561. The Texas courts have frankly announced that they will not be troubled with this question and will hold all business trusts to be in reality partnerships. Thompson v. Schmitt (1925) 115 Tex. 53, 274 S. W. 554. A similar view has been reached in Kansas and Washington, but in these latter states it is based upon a construction of the definition of a corporation in the state constitutions and the corollary holding that a business trust is merely an organization whose sponsors have not fulfilled the requisites of legal corporate existence. State ex rel. Colvin v. Paine (1926) 137 Wash. 566, 243 Pac. 2; Weber Engine Co. v. Alter (1926) 120 Kan. 557, 245 Pac. 143. The provisions involved are the same as Article 12, section 11 of the Constitution of Missouri, but the Missouri courts have not felt themselves compelled to reach this drastic result. Darling v. Buddy, supra. If the organization is in reality a partnership despite its use of the trust form, the individual unit holders are liable as partners to the full extent of their wealth to any creditor. Neville v. Gifford (1922) 242 Mass. 124, 36 N. E. 360; Rand v. Morse (C. C. A. 8, 1923) 289 F. 339. However, if there is a clause, as there usually is, in the agreement limiting the liability of the unit holders to the amount they have already paid, this clause will protect them even if the organization is a partnership if the creditor contracted with reference to it when he extended the credit. McCarthy v. Parker (1923) 243 Mass. 465, 138 N. E. 8; Oden v. Bone (Tex. Civ. App. 1924) 263 S. W. 640; and cf. Betts v. Hackathorn (1923) 159 Ark. 621, 262 S. W.
COMMENT ON RECENT DECISIONS

602 and Walker v. Hatfield (Mo. App. 1929) 17 S. W. (2d) 357 (reaching a similar result with reference to a clause limiting the liability of the trustee). If the organization created can be held to be a true trust, the courts have assumed that this is sufficient to release the unit holder, who is now a cestui que trust, from any further liability. Krey Packing Co. v. Hitchings (Mo. App. 1929) 18 S. W. (2d) 123; Henry G. Taussig Co. v. Poindexter (1930) 224 Mo. App. 580; 30 S. W. (2d) 635; and cases cited above on the distinction between partnerships and true trusts. But this result should not necessarily follow. In the law concerning normal trusts it has been held that a trustee who has been forced to pay on contracts rightfully made by him for the benefit of the trust estate has an equitable right of reimbursement from the cestui personally, if the trust estate is exhausted, provided the cestui is sui juris and has not renounced his beneficial interest. Rensselaer & S. B. R. R. Co. v. Miller (1874) 47 Vt. 146; Hardoon v. Belilios (1901) A. C. 118; Scott, Liabilities Incurred in the Administration of Trusts (1915) 28 HARV. L. REV. 727; 2 PERRY, LAW OF TRUSTS AND TRUSTEES (7th ed. 1929) 824; and cf. Hoch v. Duluth Brewing and Malting Co. (1928) 173 Minn. 374, 217 N. W. 503. There would seem to be no reason why this doctrine should not be applied to business trusts as well, unless prohibited by the terms of the trust agreement. Since this liability would be proportional to the amount of the interests of the various cestuis, rather than each being liable for the whole of the debt, it would not prove of much benefit to the creditor to force the trustee to assign this equitable right of reimbursement to him, unless the units were owned by a relatively few persons. The fact that the business trust has been discharged in bankruptcy does not protect the unit holders from any of these liabilities. National Bankruptcy Act sec. 4b (definitely providing this with respect to stockholders of corporations, while we have seen that the business trust is by definition a corporation in this Act). Apparently the only real result of throwing a business trust into bankruptcy is to substitute for the trustees some other person, presumably more satisfactory to the creditors, in the actual control of the trust assets for the purpose of their liquidation.

Thus, under no circumstances should the unit holders have been allowed to file as creditors. It is true that in the particular case the circumstances appear to be such that the unit holders were entitled to every sympathy as the victims of mismanagement and fraud by the trustee; but still these large "claims" should not have been permitted to diminish the proportion that the true general creditors would receive of their claims. To illustrate the serious practical effects of such proceedings, let us suppose that the assets of the trust available to pay general creditors amounted to $200,000, while there were ordinary creditors to the extent of $250,000 and unit holders who had paid $550,000 for their units, which were stated to have that par value. If the unit holders are not permitted to file as creditors, the ordinary creditors will receive a dividend of eighty cents on the dollar, while if the unit holders may file, both classes will receive only twenty-five cents.
on the dollar. Although the receipt of dividends after such unauthorized procedure would be effective to constitute an estoppel to contest the validity of the sale by the trustee in bankruptcy, still it is very unfortunate that the Circuit Court of Appeals did not specifically denounce the practice as being contrary to law, for the silent acquiescence in it may lead other bankruptcy courts and referees into serious error. G. W. S., '33.

JOINT TENANCY—JOINT DEPOSITS—RIGHTS OF ADMINISTRATOR AGAINST SURVIVOR.—Deceased had deposited sums of money with a bank, receiving in return time deposit certificates payable to the order of herself. Some time later she came to the bank and told the cashier she wanted to arrange it so that her husband could get the money in case she died. The cashier then cancelled the old certificates and made out a new one “payable to the order of herself . . . or . . . her husband.” After her death a dispute arose as to whether the money belonged to her husband or to the administrator of her estate. Held, that it passed directly to her husband by right of survivorship. Murphy v. Wolfe (Mo. 1932) 45 S. W. (2d) 1079. In dealing with the Missouri statute providing that when a deposit is made in the name of the depositor and another and in form to be paid to either or the survivor it becomes their joint property and on the death of either is payable to the other, [R. S. Mo. (1929) sec. 5400], the Court held that this statute did not apply in the principal case because of the narrow construction placed on that statute in previous cases by the Missouri courts. In order to come within the purview of the statute, as construed by these earlier decisions, the deposit must be made in form to be paid to either or the survivor of them. Ambruster v. Ambruster (1930) 326 Mo. 51, 31 S. W. (2d) 28; Mississippi Valley Trust Co. v. Smith (1928) 320 Mo. 989, 9 S. W. (2d) 58. Consequently the decision is based on the common law, that is, non-statutory law.

When money is deposited by A to be paid to “A or B,” there is a wide divergence of opinion among the courts as to B’s right of direct survivorship on the death of A. B’s right to the money has been sustained or denied on the basis of one of four theories, the gift theory, trust theory, testamentary theory, or joint-tenancy theory. The majority of decisions hold that in order to sustain B’s right to the fund without its passing through administration, the transaction in creating B’s interest must constitute a gift. Commercial Trust Co. v. White (N. J. Eq. 1926) 132 Atl. 761; McLeod v. Hennepin County Sav. Bank (1920) 145 Minn. 299, 176 N. W. 987; Pearre v. Grossnickle (1921) 139 Md. 274, 115 Atl. 49; Wolfe v. Hoefke (1922) 124 Wash. 495, 214 Pac. 1047. Some decisions have held that even though there is not sufficient delivery to constitute a gift, it may be sustained as a trust. Connea v. San Francisco Sav. & L. Soc. (1924) 70 Cal. App. 180, 232 Pac. 755; Ladner v. Ladner (1921) 128 Miss. 75, 90 So. 593. The soundness of this theory is questionable in view of the modern view that equity will not create a trust out of an imperfect gift.