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Corporations-Insolvency-Proof of Claims

CORPORATIONS—INSOLVENCY—PROOF OF CLAIMS—X corporation, for a valuable consideration, assumed all the liabilities of Y corporation. One of these liabilities was a claim held by appellant for $24,198.62 in the form of five promissory notes. Neither corporation at any time furnished any collateral for this indebtedness, or paid any part of same. Receivers were subsequently appointed for both corporations.

At the time of the insolvency of X corporation, the total amount of appellant's claim, including interest and attorney's fees, was $33,732.34. Appellant filed a verified claim with the receiver of X corporation for this amount.

One S, an officer of Y corporation, had prior to his death created a trust in favor of appellant in certain insurance policies on his own life.

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[6] *Bobrick v. Second Nat. Bank of Hoboken* (1916), 162 N. Y. S. 147.

[7] *Iron Co. v. Brown* (1874), 63 Me. 139; *Munroe v. Bordier* (1849), 8 C. B. 862, 137 Engl. Repr. 747; *Bergstrom v. Ritz-Carlton Restaurant & Hotel Co.* (1916), 157 N. Y. S. 959.

[8] *Butts v. Dean* (1840), 2 Metc. (Mass.) 76; *Duncan v. Kimball* (1865), 3 Wall. (U. S.) 37, 18 L. Ed. 50; *Briggs v. Holmes* (1888), 118 Pa. St. 283, 4 Am. St. Rep. 597. See *Nixon v. Beard* (1887), 111 Ind. 137, 12 N. E. 131.

[9] Sec. 28, Negotiable Instruments Law, 1926 Burns, Sec. 11387.

After the insolvency of the said corporations, the validity of this trust was established by judgment and a sum of $28,602.15, which represented the entire proceeds of said trust, was paid to appellant, and was applied in reduction of the above claim held by said appellant.

Because of this reduction of the claim by the proceeds of the trust thus created by S, the receiver (appellee) refused to allow appellant's claim for the full amount of $33,732.34 as demanded. *Held,* a creditor is entitled to prove the full amount of a claim against an insolvent corporation, notwithstanding the claim has been reduced by a third party after insolvency.[1]

There are two theories regarding the proving of claims by creditors who hold securities. One is applied as the "chancery rule," which permits a creditor to prove his claims in full, without regard to securities which he holds. The other is the "bankruptcy rule" under which second creditors are allowed to prove only the balance of their claims above the value of their securities.[2]

Indiana has followed the latter rule, as evidenced by the case of *Union Trust Co. v. Fletcher Savings and Trust Co. et al.,*[3] wherein it was held that a creditor of an insolvent corporation who has received a part of his debt by the sale of bonds given to him by said corporation as collateral securities, is not entitled to prove the full amount of the debt as a basis for determining his interest in the insolvent estate, but can prove only that portion remaining unpaid after deducting the proceeds of his security. It was upon the authority of this case alone that the Appellate Court decided in favor of the appellee herein.

But the very statement of the "bankruptcy rule," as given above, points out the distinction between the *Union Trust Company* case and the one here in question. The term "secured creditor" has its limitations. It does not include all creditors who hold collateral regardless of the source thereof. The federal rule is that to be a "secured creditor" one must hold as security property of *the bankrupt* which would otherwise swell the assets of said bankrupt, or must indirectly hold like property by having a debt obligation of another who himself holds such property.[4] Thus a holder of a note made by one now bankrupt and indorsed by third parties who put up collateral of their own as security for its payment, has been held not to be a "secured creditor,"[5] and therefore is not required to deduct the value of such securities, but may prove a claim for the full amount of the debt.

The same rule has been applied in the case of insolvency of an indorser. After the appointment of a receiver for an insolvent indorser of a note held by claimant, sixty percent of the face value of the note was paid by

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[1] *Indiana National Bank of Indianapolis v. Danner,* Supreme Court of Indiana, January 28, 1932, 179 N. E. 546, reversing the opinion of the Appellate Court in 170 N. E. 562.

[2] See *Bank Com'rs v. Security Trust Co.* (1900), 70 N. H. 536, 49 Atl. 113, 115-118, for a full discussion of these rules. Bankruptcy rule is thus embodied in 11 U. S. C. A. Sec. 93, subd. (h).

[3] 194 Ind. 314, 142 N. E. 811 (1924).

[4] 11 U. S. C. A. Sec. 1, clause 23. *In re Shatz* (1918), 251 Fed. 351.

[5] *In re Pan-American Match Co.* (1917), 242 Fed. 995.

the maker thereof. It was held that the holder of said note was entitled to prove its claim against the indorser's estate for the full amount, and to receive dividends until the forty percent balance was paid.[6]

A similar case exists where a creditor holds as security the promise of third parties to pay the debt of a corporation in case said corporation does not pay it. In such situation it has been contended that the creditor must first exhaust his securities and deduct the proceeds thereof, and then file a claim against the insolvent corporation for the balance, but it was held that the creditor could prove his full claim.[7] The court therein expressed the vital point which distinguishes between secured and unsecured creditors as follows, "In no sense is the promise property of the insolvent corporation which can inure to the benefit of its general creditors."

The case of *McGrath v. Carnegie Trust Co. et al.*,[8] which the Indiana Supreme Court aptly cited to support its decision herein, is directly in point. Therein a bank made a loan of $140,000.00 and took promissory notes therefor. The loan was made on condition that the proceeds be paid to a trustee and invested in stock, said stock then to be held as security by the bank making the loan. In fulfillment of that condition, the $140,000.00 was paid to a trust company which became insolvent after having failed to purchase the stock according to its agreement. The makers of the notes having paid the bank $16,000, it was contended that the bank would have to make a deduction from its claim of said amount. The highest court of New York[9] held, however, that the bank's share in the assets of the trust company should be computed on $140,000.00, the full amount of the trust deposit. It was declared that the contractural relationship between the bank and the trust company "had no concern with payments made by strangers."

Applying these rules to the instant case, it is obvious that the proceeds of insurance on the life of S would in no way increase the assets of the insolvent corporation or inure to the benefit of its general creditors. The trust fund created by S in favor of the appellant was in no way a security furnished by the insolvent. The appellant was not a "secured creditor". Since the corporation was insolvent, appellant's claim would necessarily yield a dividend of something less than the amount of the debt. If the amount paid by a "stranger" is deducted from appellant's claim, the appellant would thereby obviously have its rights diminished as against the true debtor. Granting, of course, that the appellant can in no event be permitted to recover more than the actual value of its claim, the result of the decision seems both logically and practically sound.

P. J. D.

EVIDENCE—INFERENCE UPON INFERENCE—Plaintiff charged defendant with negligence whereby decedent received a fatal shock of electricity. Instruction No. 5 was as follows: "hence under the law of this state an inference cannot be raised from or based upon an inference. You

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[6] *Commercial & Savings Bank v. Jenks Lumber Co.* (1911), 194 Fed. 739.

[7] *Adams v. Vancouver Nat. Bank, et al.* (Wash. 1931), 2 Pac. (2d) 684.

[8] 221 N. Y. 92, 116 N. E. 787 (1917).

[9] Cardozo, J., in *McGrath v. Carnegie Trust Co.* (1917), 221 N. Y. 92, 116 N. E. 787.