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CORPORATE FINANCE
AND
ACCOUNTING

Treating of the Corporate Finances and Securities;
the Corporate Books of Account; Reports;
Negotiable Instruments; and the
Powers, Duties and Relations
of the Corporation
Treasurer

WITH FORMS

BY
HARRY C. BENTLEY, C. P. A.

Legal Notes by
THOMAS CONYNGTON
of the New York Bar
Author of "Corporate Organization," "Corporate Management," etc.

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PREFACE.

In no other department of corporation work is there the same need for a clear knowledge of the laws, the principles and the practices which control as in that of corporate finance and accounting. In no other department of corporation work is reliable information, arranged for ready reference, so difficult to secure.

The present volume is intended to supply this need. For convenience in both treatment and use, the work is divided into six parts; the first treating of the treasurer's duties and legal obligations; the second of the corporate books of account; the third of the corporate finances including checks and dividends; the fourth of negotiable instruments; the fifth of the corporate securities; and the sixth presenting the forms used by the treasurer in the routine of his official work together with others relating to the corporate finances and securities.

The author can claim full credit only for those portions of the work which relate to the corporate accounts and reports. Responsibility for the legal portions of the volume rests with Mr. Thomas Conyngton, already well and widely known as a writer on corporate subjects. The author feels well assured that Mr. Conyngton's reputation for accuracy and for clear, non-technical treatment of corporate matters, will be all sufficient evidence of the character and value of the material contributed by him.

In the portion of the volume devoted to corporation accounting the author has endeavored to give a general idea of the principles which govern advanced modern bookkeeping. Detailed applications have not been made—save in the chapter devoted to the special and opening entries of the corporate books—but the principles are so outlined as to be readily adapted to the requirements of any particular case. The author expects to present this subject in greater detail in a further work devoted entirely to accounting.

In conclusion the author can only hope that the present volume will fulfill the end for which it was designed, i. e., to provide a reasonably complete and conveniently arranged manual for the use of the corporation treasurer and for all others interested in corporate finance and accounting.

HARRY C. BENTLEY.

229 Broadway, New York City,
Jan. 1, 1908.

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CORPORATE FINANCE AND ACCOUNTING.

PART I.—THE CORPORATION TREASURER.

CHAPTER I.

LEGAL STATUS OF CORPORATE OFFICIALS.

§ 1. General.

The treasurer is one of the executive officers of the corporation. For a clear understanding of his position, duties and liabilities, a brief consideration of the general legal status of corporate officials is essential.

The term " officers " is here applied to those permanent agents of the corporation appointed or elected—usually by the board of directors—as the direct representatives of the board and of the corporation. The directors are themselves at times and with legal correctness styled officers, but to avoid confusion the term is restricted in the present volume to the officials subordinate to the board.

The board of directors of a stock corporation, unless it is otherwise expressly provided by proper charter or by-law provision, has the entire management and control of the property and affairs of the corporation.[1] This board, however, merely directs. It decides what must be done, but its decisions are carried into effect by means of agents who are usually the

[1] Burden v. Burden, 159 N. Y. 287, 308 (1899); Sellers v. Greer, 172 Ill. 549 (1898); Ellerman v. Chicago, etc. Co., 49 N. J. Eq. 217 (1891).

officers of the corporation. In the absence of preventing statutes, the election or appointment of these officers might, by proper charter or by-law provision, be reserved to the stockholders, but almost invariably, by express statutory, charter or by-law provision, the power of appointment is vested in the board of directors. Hence one of the first actions of the board after its own election is the appointment of officers.

Certain corporate officers are usually specified and required by the statutes of the state, or by the charter or by-laws of the corporation, and as to these the board of directors has no discretion. Such officers are therefore elected as a matter of course, but beyond this the board may appoint other officers or agents as may be necessary, or it may leave the designation of subordinate agents to the executive officers of the corporation.

§ 2. Officers of a Corporation.

The necessary officers of a corporation—termed executive officers—are the president, secretary and treasurer. In the smaller corporations two of these offices are frequently held by one person. When this arrangement exists, it is usually authorized by a charter or by-law provision, but without such authorization the board would still have power to combine any two non-conflicting official positions in one person if it seemed desirable. It is imperative, however, that the duties of the combined positions should not conflict.[2] For instance, where the statutes require the president and treasurer to sign stock certificates, as is the case in New Jersey, or where the by-laws require the treasurer to sign and the president to countersign checks, as is frequently the case, these two offices cannot properly be combined in one person.

In the larger corporations, on the other hand, additional officers are frequently elected, such as one or more vice-presidents, a managing director or a general manager, a counsel,

[2] People v. Green, 58 N. Y. 295, 304 (1874); Sargent v. Webster, 54 Mass. 497 (1847); II Cook on Corps., § 712.

an auditor and various assistant officers. The power to elect these additional permanent officers is usually conferred and its exercise made incumbent on the board by the charter or by-laws, except as to the less important officials, whose appointment is ordin; rily left entirely to the discretion of the board.

§ 3. Powers and Duties of Corporate Officials.

The routine duties of the various officers are usually set forth in the by-laws of the corporation. Other duties are sometimes prescribed by the charter of the corporation or by the statutes of the state. In addition to these, the officers must perform such other acts and duties as may be properly required of them by the board of directors.[3]

The officials of a corporation have only such power as is conferred upon them, and the mere fact of election to office does not in itself confer any power.[4] Custom or usage may have attached certain duties to certain offices, but the corporation may disregard this custom or usage and assign such duties to the different officials as it sees fit. Speaking generally, then, by mere virtue of his office, "the president of a corporation has no power to buy, sell or contract for the corporation, nor to control its property, funds or management,"[5] nor has the secretary or treasurer any greater power.[6] To legally act for their corporation, to properly bind it by contract and to deal generally with third persons in its behalf, the officers must be authorized thereto either by the statutes of the state, the charter or by-laws of the corporation, the resolutions of the board of directors, or, in the silence of these superior authorities, by usage.

Under these circumstances, when the board elects or

[3] East, etc. Co. v. Brower, 80 Ga. 258 (1888); Madison, etc. Co. v. Griffin, 3 Ind. 277, 282 (1852).

[4] R. R. Co. v. Bayne, 11 Hun (N. Y.) 166, 171; Aff'd, 75 N. Y. 1 (1877).

[5] II Cook on Corps., § 716.

[6] Hallenbeck v. Casket Co., 117 Mich. 680, 684 (1898); Alexander v. Cauldwell, 83 N. Y. 480 (1881); Craft v. R. R. Co., 150 Mass. 207 (1889); III Clark & Marshall on Corps., §§ 701, 703, 704, 728.

appoints a person as treasurer of the corporation, the appointee does not necessarily step into a position of generally recognized and clearly defined duties. On the contrary, in every corporation the requirements might be different. Usually there is a great similarity in the duties of the treasurer's office in different corporations, but this is a matter of custom and convenience, and not of necessity.

Generally it may be said of corporate officials that they are the agents of the corporation and that there is no difference between the rules applying to the agents of a corporation and the agents of a natural person. The general law of agency applies to both. In either case the agent has only those powers which are expressly given him, or are conferred upon him by usage or custom, or which are incidental to the exercise of these powers. A corporate official must therefore, in order to determine his powers and his duties, examine the different sources from which his authority is derived. These empowering authorities are as follows:

§ 4. (a) Statutory Provisions Affecting Corporate Officials.

There are no federal laws prescribing or directly affecting the powers and duties of corporate officials. There are, however, in many of the states some few statutory provisions, i. e., state laws, applying to or affecting the officers of corporations, and these are of the highest authority, being superior to the charter or by-laws of the corporation. That is, should the charter or by-laws deny an officer authority conferred on him by statute, or should they attempt to confer on him some authority expressly denied by statute, such charter or by-law provision would be absolutely void and of no effect.

Statutory provisions affecting corporation officials are very limited as to scope and number. Some states have none. In other states the statutes merely specify that a president, secretary and treasurer, and perhaps other necessary officials, may be elected and that the by-laws shall prescribe their duties.

In some states the laws provide that the treasurer must give bond, in others that the secretary must be sworn to the faithful discharge of his duties. Or again the laws will provide that the treasurer must allow stockholders to inspect the corporate books of account. In many states a punishment is imposed for making false or fraudulent entries in the books, for issuing misleading statements, and for failure to make certain prescribed reports.

It is, however, generally true that state legislatures have not felt it necessary to prescribe the duties of corporate officials. Incidental provisions are found, but in every state of the Union the main powers and duties of the corporate officials are left to be determined by the corporation itself, and no material statutory restrictions exist as to the powers that may be conferred or the duties that may be assigned.

This being so, it is obvious that the duties of the same officer in different corporations may be very different. The custody of the corporate funds might, should the corporation see fit, be assigned to the president, or the accounts of the corporation might be entrusted to the secretary, or the duty of keeping the corporate records might be assigned the treasurer. Usage prescribes certain duties for certain officers, but the corporation is not bound in this manner by usage and may modify or change the customary duties of its officers as seems to it best. In practice, minor changes in the duties of officials are common.

§ 5. (b) Charter Provisions Affecting Corporate Officials.

Next in authority to the statutes in corporate matters comes the charter of the corporation. Under the usual laws regulating incorporation, provisions affecting the powers and election of officers cannot be incorporated in the charter. In some states the inclusion of such provisions is permitted by express statutory enactment, as in New Jersey or New York, where the charter may contain " any other provision for the regulation of the business and conduct of the affairs of the corporation and any limitation upon its powers, and upon the powers of its directors and stockholders which does not exempt them from any obligation or from the performance of any duty imposed by law."[7] The privilege is, however, rarely exercised as to the powers and duties of officers because changes may be desirable in these matters and if they have been incorporated in the charter, such changes are usually difficult and expensive and, in the face of opposition, sometimes impossible.

At times, however, provisions of special importance or permanence affecting the officers of the corporation are inserted in the charter for the express purpose of embarrassing or preventing changes. For instance, limitations may be placed by charter provision upon the compensation of officers, or qualifications may be prescribed, or special powers may be conferred upon certain officials.

§ 6. (c) By-Laws Affecting Corporate Officials.

The by-laws[8] rank next in authority to the charter. They are usually adopted by the stockholders, though the power to amend and even to make them is sometimes delegated more or less fully to the directors.

The by-laws are peculiarly suitable for the regulation of matters such as the powers and duties of officers. The charter, as already stated, is not only too difficult of change to make it generally desirable for this purpose, but in many states is absolutely unavailable. The by-laws, on the other hand, are sufficiently authoritative and of such reasonable permanence as to fit them for this purpose, but, should the necessity arise, may be amended or repealed without the delay, formality and expense incident to an amendment of the charter. At the same time such change may only be made by certain prescribed methods—usually set forth in the by-laws themselves—which effectually prevent hasty and ill-considered alterations.

[7] Bus. Corp. Law, N. Y., § 2.

[8] See Chap. IV, "By-Law Provisions Affecting Treasurer"; also § 24.

The by-laws usually prescribe the duties of the corporate officials in detail, and also define the scope of their powers, provide the manner of their election, the method of filling vacancies, and such other general or specific regulations and provisions as are not to be left to the discretion of the directors. Many of these matters could not properly or conveniently be provided for elsewhere and if not included in the by-laws, would be left in a very ambiguous and unsatisfactory condition.

When the by-laws, as is usually the case, prescribe official powers, procedure and duties with fulness, it only remains for the board to provide for additional or special powers and duties, as the necessity arises.

§ 7. (d) Resolutions of Directors.

Next in authority to the by-laws come the resolutions of the directors. The directors are subject to and must comply with any provision of the state laws, and of the charter or by-laws of the corporation as far as applicable. These, however, are usually concerned only with methods and matters of routine procedure intended to secure the smooth and proper working of the corporate mechanism; hence the actual charge and control of the property, affairs and business of the corporation rest almost entirely in the hands of the directors.

For instance, the by-laws will prescribe perhaps that all important contracts entered into by the corporation shall be signed by the president and the treasurer and be sealed with the corporate seal. This fixes absolutely the method by which such corporate contracts shall be evidenced, but it does not restrict the directors in any way as to what contracts the corporation shall enter into nor does it compel them to enter into any contracts at all. As to these matters of practical business, they are free to use their discretion. The manner is prescribed but not the matter. General restrictions may perhaps exist, as a debt limit or a maximum salary provision, or requirements as to surplus, but these can be but general and the directors are for all practical purposes in absolute control of the actual business operations of the company. Accordingly, as the various current matters come up, the directors consider and act upon them, and their action is authoritative and final.

§ 8. (e) Usage as a Source of Official Power.

When a corporation has been in existence for a term of years it will usually be found that the officers transact certain routine business as a matter of course and without any specific authorization. Notwithstanding this apparent lack of authority, the acts and contracts of the corporate officials in such matters are binding upon the corporation and upon the other parties as well.[9] Usage has taken the place of direct authorization.[10]

Also if a corporation official performs duties which it is customary for such an official to perform, his action will be held valid and binding upon the corporation even though not specifically authorized,[11] provided only that the other parties do not know that the official is exceeding his authorized power.

For instance, the by-laws of a corporation might designate some official other than the treasurer as the proper party to receive and receipt for all moneys due. Nevertheless, if the treasurer received money due the corporation from some one not aware of the treasurer's lack of the usual power, and gave a receipt therefor, the payment would be held good and the receipt conclusive, and this even though the treasurer diverted the money to his own use.[12] The treasurer might be liable for any loss resulting from his unauthorized action, but the corporation would be bound.

Or if a railroad appoints a purchasing agent, the mere

[9] Fitzgerald, etc. Co. v. Fitzgerald, 137 U. S. 98 (1890); G. V. B. Min. Co. v. Bank, 95 Fed. Rep. 23 (1899); Phillips v. Campbell, 43 N. Y. 271 (1870).

[10] See Chap. III, "Duties and powers of Treasurer."

[11] Insurance Co. v. McCain, 96 U. S. 84 (1877); N. Y., etc. R. R. Co. v. Schuyler, 34 N. Y. 30 (1865); Story on Agency, §§ 126, 127.

[12] Rathbun v. Snow, 123 N. Y. 343 (1890); Mining Co. v. Bank, 104 U. S. 192 (1881).

fact of his position makes it entirely safe for third persons to contract with his railroad through him, for the usual railroad supplies; or if a corporate officer placed in charge of a mercantile business buys goods dealt in by his corporation, his contracts for such goods are binding upon the corporation.

In all cases when the officers act as a matter of custom or routine and without specific authority, the corporation is estopped from denying the official action because it has, in name at least, placed its officers in positions which customarily confer the right to perform such duties, or otherwise has habitually allowed them to act in such matters.

A corporate officer cannot, however, undertake a transaction outside of his usual duties or routine and bind his corporation, unless specifically authorized thereto, and it is unsafe for a third person to deal with him in such matters unless first assured of his authority.[13]

§ 9. (f) Ratification of Official Actions.

In all cases where an officer exceeds his authority in contracting or otherwise acting for a corporation, the corporation may, by ratifying the transaction, make it its own. The company is also bound by the implied ratification involved in an acceptance of the benefits of any such contract or other act. In either case, the officer by whom the act was performed is released from personal responsibility by the corporate ratification and the corporation, on the other hand, is liable exactly as if the officer had been duly authorized from the first. In other words, ratification is authorization though after the fact.

Officers not infrequently act without formal authorization, relying upon ratification by the board of directors later. In any such case, if the board ratifies their action, the officials involved are absolved from all responsibility in the matter,[14]

[13] Slattery v. Bank, 175 Mass. 380 (1900); Craft v. S. B. R. R. Co., 150 Mass. 207 (1889); 5 L. R. A. 641; First Nat. Bk. v. Lumber Co., 116 N. C. 827 (1895); Jewett v. Bank, 173 Mass. 54 (1899); see also § 49.

[14] Rolling Mill v. Railroad, 120 U. S. 256 (1886); Nims v. Boys' School, 160 Mass. 177 (1893); Sheldon Co. v. Eickmeyer Co., 90 N. Y. 607 (1882); Northwestern Fuel Co. v. Lee, 102 Wis. 426 (1899).

but if not, they are themselves personally liable to the parties with whom they dealt. "Whenever a person enters into a contract as an agent for another, he warrants his own authority, unless very special circumstances, or express agreement relieve him from that responsibility."[15]

[15] White v. Madison, 26 N. Y. 117 (1862); see also §§ 21, 49.

CHAPTER II.

THE TREASURER AND HIS OFFICE.

§ 10. Qualifications.

The statutes of the various states concern themselves but little with the qualifications of the corporate officials. In the case of the treasurer the statute requirements are particularly scant. In Arkansas he must be a resident of the state. In Michigan he must reside in the state and transact the corporate business in the principal office which must also be in that state, unless the charter permits its location elsewhere. In Ohio all the executive officers must be stockholders of the corporation and the principal accounting officer must be a resident of the state.

Beyond these, some few after-qualifications, principally as to bonding,[1] are prescribed in a number of states, but in the main the qualifications of the treasurer are left to be determined by the corporation and primarily by its stockholders. Speaking generally, the stockholders may prescribe any desired qualifications for their treasurer. They may, if they see fit, impose a property qualification, or require that he shall be a stockholder or a director of the company, or that he be a resident of the state, or they may authorize the directors to prescribe his qualifications and leave the whole matter to them.

When not otherwise prescribed by the state laws or by the charter or by-laws of the corporation, any person who may

[1] See Chap. VIII, "The Treasurer's Bond."

act as agent for another is eligible to act as treasurer of the corporation. Thus in the absence of prohibition, a married woman, a minor, an alien, one of its directors or even another corporation might be elected and legally serve as its treasurer. Nor does election to another office in the same corporation in itself disqualify an incumbent to act as treasurer, provided the duties of the two offices do not conflict.

From the practical standpoint it is desirable that the treasurer of a corporation be of strict honesty, unblemished reputation and financial responsibility. In such case the character of the treasurer is in itself an element of strength, giving standing and solidity to the corporation.

In the smaller corporations the treasurer is usually either acting bookkeeper or has direct control of the books of account and keeps his own special books as well. A knowledge of bookkeeping and of the financial duties connected with his office is then a necessary qualification.

In the larger corporations the treasurer's duties do not usually include the details of accounting. These devolve upon subordinate employees or are perhaps relegated to an accounting department, leaving the treasurer free to devote his attention to the general oversight and management of the corporate finances and financial affairs. A knowledge of accounts and bookkeeping, though desirable, is not then so essential as it is in the smaller corporations.

In many of the larger corporations the actual duties of the treasurer are nominal, the usual duties of that official being assigned to other officers or employees of the corporation. The treasurer is then as a rule selected because of his financial responsibility or connections, or for other reasons that make his election desirable.

When qualifications are prescribed for the treasurer of a corporation they usually and preferably appear in the by-laws, though occasionally they are found in the charter. In Utah the statutes require that the qualifications of all corporate officers must appear in the charter.

§ 11. Appointment.

As already stated, the appointment or election of the treasurer in common with that of the other corporate officials, rests primarily with the stockholders. The power to elect officers has, however, been largely regulated by statute provision. Thus in many states the officers may be elected only by the directors. In other states the statutes provide that the stockholders may, if they wish, by proper charter or by-law provision, reserve the election of officers to themselves. Also in any state where no statutory provisions conflict, the stockholders might reserve the right if they so desire to. Such reservation is however, rarely made, the power to elect officers being almost invariably conferred upon the directors.

Occasionally special charter or by-law provisions prescribe that the treasurer shall be elected by a certain class or portion of the stock, or by certain members of the board of directors. Such arrangements are possible only in those states where they are expressly permitted by or do not conflict with existing statutes. Their purpose is usually to insure official representation to certain classes of stock or to particular interests among the stockholders. Provisions of the kind are not common and but seldom desirable.

Statutory provisions directly affecting the election of the treasurer are rare, and in most cases of but little real importance. As already said, in some states the statutes provide that the treasurer, in common with the other officers of the corporation, must be elected by the board of directors; in others, that he may be elected by the stockholders, if so prescribed. Incidental provisions are also found, as in Florida where the officers of a corporation and the time of their election must be set forth in the charter, or as in Tennessee where the corporate officials may not hold office for more than two consecutive years, a third term being thereby prohibited, or as in Utah where the time and manner of electing the corporate officials must appear in the charter.

§ 12. Assumption of Official Duties.

The procedure and formalities when the newly elected treasurer assumes the duties of his office, are simple. Usually he is required to give bond, and this must be done in accordance with the requirements of the particular corporation before he may enter upon the duties of his office. As soon, however, as he has qualified for his position by giving a satisfactory bond and complying with any other requirements of the corporation, he is ready and entitled to take possession of his office and begin the discharge of his official duties.

The retiring treasurer, on the other hand, retains his position as treasurer of the corporation and has authority to perform all its usual duties until the treasurer-elect has qualified and assumed the duties of his office. Then, however, the authority of the retiring treasurer immediately terminates, he is no longer competent to exercise any of the functions of the office, and, unless otherwise instructed by the board, must at once turn over to the new official all corporate property in his custody, including the books of account.

The retiring treasurer, in preparation for the surrender of his office, usually closes his books and prepares a balance sheet, giving a more or less complete statement of the general financial condition of the corporation. Also an audit of his accounts is customary and desirable, particularly when the corporate assets are material.

The audit of the retiring treasurer's books relieves the incoming treasurer from any responsibility as to their condition. He takes them as they are, but must assure himself that the corporate funds and other property turned over to him by the retiring treasurer accord with the books. If he does not, his negligence in the matter may render him liable for any resulting loss to the corporation.

The incoming treasurer should at once notify the depositaries in which the corporate funds are held of his election and assumption of office. If the corporate funds have been deposited in the name of the treasurer of the corporation, it will be necessary for them to be transferred to the treasurer-elect by check of the retiring official. If, however, the funds are deposited in the corporate name, no such transfer is necessary. There is then no change in their ownership but merely a change in the officer by whom checks are drawn, and proper certification to the bank of this change is all that is required.[2]

The corporate accounts must always be surrendered by the retiring treasurer even though the books in which they are kept have been purchased with his private funds.[3] Should the outgoing treasurer refuse to turn over to the treasurer-elect any property which belongs to the corporation, the directors, or even the treasurer himself, may bring suit for its recovery.[4] As a matter of course, the treasurer will give his predecessor a receipt for the corporate property turned over.

§ 13. Tenure of Office.

In Tennessee the statutes provide that the officers of a corporation may not hold their official positions for more than two years and in that state any provision for a longer term of office for the treasurer would be void. Elsewhere there is no statutory provision which directly limits the period for which the treasurer may be elected, but in common with the other officers of the corporation, a year is his usual term.

In the absence of restraining statutes, the term for which the corporate officials are elected might be extended beyond the usual period by proper charter or by-law provisions. Business policy, however, usually prohibits a longer term than that enjoyed by the directors by whom the officials are elected. That is, if the directors are elected annually, the officers should also be elected annually.

[2] See § 211.

[3] State v. Goll, 32 N. J. L. 285 (1867); see § 19, *infra*.

[4] High on Extraordinary Legal Remedies, § 306; State v. Riedy, 50 La. Ann. 258 (1898); Matter of Journal Pub. Club, 30 Misc. Rep. (N. Y.) 326 (1900); Am., etc. Co. v. Haven et al, 101 Mass. 398 (1869).

The wisdom of such a rule is obvious. The directors are held responsible for the proper management of the corporate affairs and to secure this it is essential that harmonious relations should exist between them and the officers upon whom the execution of their plans depend. When the directors elect their own officials, they naturally select parties who are acceptable to them and upon whom they can depend for the fullest support and co-operation. If, however, they were forced to accept officials appointed by a preceding board, these desirable conditions would not in many cases exist and the business of the corporation would suffer.

The treasurer's official status is at once terminated by his legal removal, death or peremptory resignation, but is not necessarily terminated by the close of his elective term. It ends there if his successor is elected and assumes the duties of the position, but otherwise continues until he is relieved by a duly appointed and qualified successor.

In some states this is a matter of enactment, the statutes providing specially that in case of any failure of election the old officials shall continue in office until the appointment of their successors. The same provision almost always appears in the by-laws. If not found in either statutes or by-laws, the old officials still hold over as a matter of common law and their acts are valid until they are relieved by legally appointed successors.[5]

§ 14. De Facto Officers.

A *de facto* officer is one actually in possession of an office and exercising the rights and duties of that office by virtue of some other authority or right than that of a regular and unquestioned election or appointment. He must be "distinguished on the one hand from a mere usurper of an office, and on the other hand from an officer *de jure*. He is one who is in actual possession of an office under the claim and color of

[5] Mining Co. v. Abraham, 26 Ore. 282 (1894); Thorington v. Gould, 59 Ala. 461 (1877); Milliken v. Steiner, 56 Ga. 251 (1875); Agricultural Society v. Houseman, 81 Mich. 609 (1890).

an election or appointment and is in the exercise of its functions and in the discharge of its duties."[6]

It not infrequently happens that the apparent results of an election are disputed. In such case, if the officers claiming election enter upon their official duties, they are termed and considered *de facto* officers until they are either ousted or the fact of their election is definitely determined. Notwithstanding the doubt as to their titles, they are, as *de facto* officers, representatives of the corporation, their officials acts are good, and the corporation is bound thereby.

Likewise it frequently happens that an election of officers fails or is not held on the specified date. As already stated, the old officers then hold over until their successors are elected and enter upon the duties of office. These hold-over officials are, for the hold-over period, *de facto* officers and their acts are legal and binding upon the corporation.

The doctrine of *de facto* officers is of special interest as applied to the treasurer, on account of the nature and importance of his duties. To act as a *de facto* officer, he must be in actual possession of his office " under claim and color of an election or appointment " and in the actual discharge of its duties. Also the performance of his duties must be of such reasonable publicity and official character as will serve to inform all interested parties that he is discharging the duties of the office and that he claims the rights of his official position. Then until he makes way for a duly appointed successor or is sooner dislodged by legal proceedings, he is in fact, what he claims to be, the treasurer of the corporation.

§ 15. Compensation.

The compensation of the treasurer is a matter purely between the corporation and himself. Usually he receives a fixed salary. Sometimes, however, he serves without direct

[6] Waterman v. Chicago, etc. R. R. Co., 139 Ill. 658, 665 (1892); Merchants' Bank v. Citizens' Gas Light Co., 159 Mass. 505 (1893); Mining Co. v. Anglo-Cal. Bk., 104 U. S. 192 (1881).

compensation because perhaps of the nominal nature of his duties, or to conserve his interest as a stockholder in the company, or because the position is to his general business advantage, or for some other adequate reason. As the treasurer does not then, as an invariable rule, receive a salary for his services, if a salary is to be paid the matter should be clearly and formally established, and the amount be fixed at the time of the treasurer's election.

If this is not done the treasurer, if he is a stockholder or a director of the corporation, will not be able later to enforce payment for his services already rendered, even though it was intended he should be paid. Under such circumstances he is interested in the success of the corporation entirely apart from his treasurership, and if he serves for some considerable time without salary and without any agreement as to salary, it is a fair presumption that no salary was intended. This doctrine is well established, the courts holding with much uniformity that a stockholder or director is not entitled to compensation for services rendered as treasurer of the corporation, unless there has been a specific agreement therefor.[7]

In case the treasurer is not a stockholder, there is no question as to his right to compensation if he renders services to the corporation, either as a treasurer or in any other capacity. He is then a stranger and entitled to whatever his services are fairly worth without question as to whether or no a previous agreement for compensation has been made.[8]

Unless otherwise prescribed by charter or by-law provision, the treasurer's salary is fixed by the board of directors. If the treasurer is himself a member of the board, it is preferable that his salary be prescribed by the by-laws, as payments made by the board of directors to one of its own members are scrutinized closely by the courts in case of question, no matter what the conditions.

[7] Kirkpatrick v. Penrose Ferry Bridge Co., 49 Pa. St. 118 (1865); Mather v. E. M. Co., 118 N. Y. 629 (1890); Holder v. Laf. B. & Miss. Ry. Co., 71 Ill. 106 (1873).

[8] Smith v. Long Island Ry. Co., 102 N. Y. 190 (1886).

If, however, the salary of the director-treasurer is not fixed by the by-laws, the directors may in advance vote any fair compensation for his services as treasurer and their action will be valid, provided that he does not participate in the vote fixing his compensation nor assist its passage in any other way. As a precautionary measure, he should not even be in the room when the vote is taken. If he is present and votes on the matter, or if he is merely counted to make up the quorum at the meeting, the agreement is void and cannot be enforced. The treasurer might in such case, bring suit against the corporation for the actual value of the services rendered, but recovery would be doubtful and he could not base any claim upon the agreement for his salary.[9]

If the treasurer's salary is not paid, he may bring suit against the corporation but cannot seize upon corporate funds in his hands to pay the claim, nor withhold its amount before turning over the corporate property at the close of his term of office.[10]

It may be noted in passing that the treasurer cannot legally receive secret commissions or profits from parties selling to the corporation. If he makes any such profits, they belong to the corporation and if the transaction is discovered, the treasurer may be forced to restore them.[11]

§ 16. Vacancies.

The by-laws usually prescribe how vacancies among the officials shall be filled. If not, this power exists in the original appointing body. Thus, if the treasurer is elected by the stockholders, the stockholders will also fill any vacancy in his office, but if he is elected by the board of directors, the board has

[9] Butts v. Wood et al, 37 N. Y. 317 (1867); Davis v. Thos. A. Davis Co., Court of Chancery of N. J. (1902), 52 Atl. Rep. 717; Kelsey v. Sargent, 40 Hun 150 (1886); Copeland v. Johnson Manuf. Co., 47 Hun 235 (1888).

[10] First Nat. Bk. v. Barnum Wire Works, 58 Mich. 124 (1885); Tagg v. Bowman, 99 Pa. St. 376 (1882); S. C., 108 Pa. St. 273 (1885).

[11] Clark & Marshall, § 2289 et seq; Clark & Skyles on Agency, § 406; Campbell v. Cypress Hills Cemetery, 41 N. Y. 34 (1869); Dutton v. Wilner, 52 N. Y. 312 (1873); McClure v. Law, 161 N. Y. 78 (1899); Parker v. Nickerson, 112 Mass. 195 (1873).

power to appoint a successor in case of his death, resignation or removal, even though such power is not conferred by the by-laws.[12] In any such case the appointment is for the remainder of the unexpired term.

If the election of treasurer is reserved to the stockholders, as is occasionally the case, the by-laws might very properly give the directors power to fill any vacancy in the office for the unexpired term. In the absence of such provision, the board would undoubtedly have power to fill any such vacancy by the appointment of a temporary treasurer, who would hold until action was taken by the stockholders.

A treasurer legally elected or appointed to fill an unexpired term, has every right, power and duty of a treasurer of the corporation, to the same extent as had the original incumbent. He does not, however, necessarily succeed to any special privileges or emoluments granted his predecessor. For instance, if the board had paid his predecessor an unusually high salary in order to secure his acceptance of the position, the incoming treasurer, in the absence of any agreement, would have no legal claim to this salary, the amount of his compensation being purely a matter for adjustment between himself and the directors.

§ 17. Removal.

As the board of directors is responsible for the proper conduct of the corporate affairs, and as this is largely dependent upon the character and performance of the corporate officers, the directors should not only have power to elect these officials but to remove them as well, whenever they fail in either of these particulars.

As a matter of fact, the board may remove the corporate officials whenever adequate cause exists. For instance, if the treasurer embezzles the corporate funds, or persistently fails to safeguard them properly, or is so negligent in the discharge of

[12] In re Griffing Iron Co., 63 N. J. L. 168, 357 (1889).

his general duties as tq menace the welfare of the corporation, the directors have full power to remove him, although the right may not have been specifically granted them. Further than this, even though the treasurer be elected by the stockholders, the directors still have power to remove him for due cause, unless such power has been expressly denied them or unless some other adequate provision has been made for his removal.[13]

Usually when an official is to be removed for cause, charges must be made, he must be duly notified of these charges and be given an opportunity to be heard in his own defense. Speaking generally, unless specially authorized thereto, the board has no right to remove an officer without careful adherence to this procedure and may render the corporation liable for damages to the deposed official if it does.

In New York, however, and in some few other states, the statutes give the board of directors power to remove the officers of the corporation *at pleasure*. Under this law the board may remove any officer at any time, without preferring charges, or giving any reason for its action, and no matter how unjust the removal, the displaced officer has no recourse. This power of peremptory removal sometimes works a hardship on the corporate officials but also at times operates much to the advantage of the corporation.

Where this power of removal is not given by statute, it may be obtained by proper provisions in the charter or by-laws.[14] These usually provide that the directors may remove the corporate officials at any time, usually by some prescribed majority. Thus in the by-laws of the United States Steel Corporation, we find the following provision: "All officers and agents shall be subject to removal at any time by the affirmative vote of a majority of the whole Board of Directors." Sometimes the power of removal is exercised by the

[13] State ex rel Bornefeld v. Kupferle, 44 Mo. 154 (1869); People v. Higgins, 15 Ill. 110 (1853).

[14] Darrah v. Wheeling Ice & Storage Co., 50 W. Va. 417 (1901); Douglass v. Mchts. Ins. Co., 118 N. Y. 484 (1890).

stockholders, but only when the right is reserved to them by express provision in charter or by-laws.

When the charter or by-laws provide for removal at pleasure or at discretion, all officers elected accept their positions subject to the operations of these provisions and they cannot therefore complain or resist, even though the power be used arbitrarily.

The force of such by-law provisions as to officials in office at the time the provisions are adopted, depends upon the conditions. Speaking generally, a by-law providing for the removal of corporate officers at the pleasure of the board might be made immediately effective, and the treasurer or any other officer be removed thereunder at once, even though in the midst of his term.[15]

In case of the disability, neglect of duty, removal from the vicinity, etc., of a corporate official, difficult questions sometimes arise. In event of disability it is presumable that the treasurer will resign, but if he does not, the board has no authority to remove him unless such power is expressly given by statutes, charter or by-laws. Even when the power is given, it is often difficult to decide just what constitutes disability sufficient to justify removal. The treasurer's temporary incapacity, such as might be occasioned by an ordinary illness or accident, would not be sufficient cause. A prolonged illness might be adequate. A mental disability of indefinite duration would undoubtedly be good ground for removal. In each case the question of fact must first be ascertained and considered before action is taken. The disability, to justify removal, must be real, of some degree of permanence and such as to incapacitate the official for the time at least for the proper discharge of his official duties.[16]

If the directors are authorized to remove officers at pleasure, an official may be removed with or without cause and he

[15] Douglass v. Mchts. Ins. Co., 118 N. Y. 484 (1890); In re Griffing Iron Co., 63 N. J. L. 168 (1899); Ostrom v. Greene, 161 N. Y. 353 (1900).

[16] Commonwealth v. Detwiller, 131 Pa. St. 614 (1890); Halpin v. Mut. Brewing Co., 20 App. Div. (N. Y.) 583 (1897).

cannot resist such removal, nor does it give him any ground for action against the board of directors or against the corporation. If, however, the board has not been given this broad power of removal, but nevertheless attempts to vacate the treasurer's office without cause or, as the incumbent believes, without sufficient cause, two courses are open to him. (1) He may turn over the corporate books and property in obedience to the instructions of the directors and then proceed against the corporation for breach of contract.[17] The sufficiency of the cause for his removal must then be passed upon by the courts as a necessary feature of the case. (2) He may resist the contemplated removal, formally protesting against it and refusing to turn over the corporate property in his custody.

If the treasurer adopts the latter course, refusing to surrender his office when his removal is attempted, and material corporate property is in his hands, the directors will be forced to proceed against him to recover possession of this property and the whole question of the legality of his removal will then come up for consideration by the courts.

If the treasurer has no corporate property of any material value in his hands, a refusal to give up his office when his removal is attempted, would usually avail him but little. The directors in such case might publicly announce the fact of his removal and the election of his successor. Then if the directors placed this successor in possession of the office, he would be, *de facto,* the treasurer of the corporation. The removed treasurer would, under such circumstances, have no actual official standing though his removal might have been absolutely illegal, and his only recourse would be an action either for damages or to decide the title to the office.

In case of peremptory removal by duly authorized action of the board, the treasurer ceases at once to be an official of the company as soon as the board's action is made public, or is notified to him. A resolution for removal might, however,

[17] Douglass v. Mchts. Ins. Co., 118 N. Y. 484 (1890); In re Griffing Iron Co., 63 N. J. L. 168, 357 (1889).

fix some future date on which it is to become effective, and in that case the treasurer would retain his official status and position until the specified date.

Should the one-time treasurer of a corporation, who has been removed or has resigned from his office, or has been superseded by the election and qualification of his successor, represent himself as the competent and acting treasurer of the corporation, his actions would not bind it, he would be liable for any losses resulting from such acts or representations,. and he might be subject to criminal prosecution as well.

§ 18. Resignations.

The treasurer in common with the other officials of the corporation has a general right, which cannot be denied him, to resign at any time. The mere fact of having been elected to his office and having entered upon his duties does not impose any legal obligation upon him to continue or complete those duties unless an express contract has been made to that effect.[18] An exception to this general statement might possibly be found in some unusual conditions under which the treasurer's peremptory resignation would seriously injure the affairs of the corporation, while no good reason could be shown for his withdrawal.

The effect of a resignation depends upon its nature. If the resignation merely reads, " I hereby tender my resignation," or states that it is " to take effect upon acceptance," formal action on the part of the board is required to make it effective. If, however, it is peremptory as " I hereby resign my position as treasurer," or states that the resignation is " to take immediate effect," the resignation is effective, regardless of its acceptance or rejection by the directors, from the date it is handed to the proper representative of the corporation,[19]

[18] Manhattan Co. v. Kaldenberg, 165 N. Y. 1 (1900); Yorkville Bank v. Zeltner Brewing Co., 80 App. Div. (N. Y.) 578 (1903); Zeltner v. Zeltner Brewing Co., 174 N. Y. 247 (1903).

[19] Int. Bank v. Faber, 86 Fed. Rep. 443 (1898); Chandler v. Hoag, 63 N. Y. 624 (1875); Morawetz on Corp., § 563; 17 Am. & Eng. Ency. of L., 169.

which in this case would be its secretary or president, or any member of the board of directors. If he so desires, the treasurer may fix some definite future date on which his resignation becomes effective and upon that date he ceases to be the treasurer of the company without further action on his part and without acceptance of his resignation by the directors.

If the treasurer's peremptory resignation is once properly brought before the directors, he cannot recall it, save with the consent of the board, even though it is not effective until a specified future date. In case of a tentative resignation as " I hereby tender my resignation," or a qualified resignation which is " to take effect upon acceptance," the treasurer may recall the resignation at any time before its acceptance by the board. After its acceptance, however, it cannot be withdrawn save with the board's formal consent, which is in effect a re-election to his office.

The treasurer cannot escape legal responsibility for any of his official acts by resignation, even though it be peremptory and immediate, but he may relieve himself thereby from further liability for actions of the corporation and of responsibility for the further duties of his office. He has ceased to be treasurer of the corporation and while he is liable for any acts already performed, and for the safe return of any corporate books and property still in his hands, he can be held for nothing beyond. He cannot escape the past but he may avoid the future.

§ 19. Formalities on Giving up Office.

When the treasurer relinquishes or is ousted from his position, all properties of the company in his possession, including the books of account, should be surrendered to his successor or to such other party as may be designated by the board of directors. The incoming treasurer is the usual and proper party to whom such property is delivered, but the directors have power to designate some other responsible party, if they see fit. The retiring treasurer should be given receipts for all properties turned over.

The corporate accounts are always the property of the corporation. Sometimes in the smaller corporations the books in which these accounts are kept have been purchased by the treasurer personally and the question as to their ownership then arises. As a matter of law, the treasurer must surrender the books in which the accounts are kept although these books have been purchased with his personal funds. He is entitled in such case to payment for the books but he cannot withhold them as a means of enforcing this payment or on the plea that they are his.[20]

In order to prevent any complications on this score, it is sometimes provided in the by-laws that the accounts of the company shall be kept in books belonging to the corporation. Also a provision is frequently inserted in the by-laws requiring that the corporate books of account shall be surrendered to the company by the treasurer at the expiration of his term of office. A similar provision is usually included in the treasurer's bond.

[20] State v. Goll, 32 N. J. L. 285 (1867); High on Extraordinary Legal Remedies, § 306; see also § 12.

CHAPTER III.

DUTIES AND POWERS OF THE TREASURER.

§ 20. As Derived From Usage.

The special duty of the treasurer as fixed by immemorial custom is to receive, care for and pay out the corporate funds.[1] This duty and the incidental powers necessary to its performance inure to him as a matter of course and in all cases, unless expressly denied by some competent authority, such as a charter or by-law provision. Beyond this the treasurer has no corporate duties or powers whatsoever save as they are given or allowed him by the corporate authorities. He is merely a special agent of the corporation appointed to care for its funds, and if he is to perform other duties, these must be assigned him and he must be empowered to their performance as in the case of any other agent.

If the treasurer does act beyond the scope of his usual powers or duties, it is presumable that he has been duly authorized thereto, but if this is not the case the corporation is not bound by his acts and those dealing with him should, as a first step, ascertain the exact extent of his authority.[2] " He who deals with a corporation is chargeable with notice of the purpose for which it was formed; and when he deals with agents or officers of one of them, he is bound to know their powers and the extent of their authority. Corporations, like natural persons, are bound only by the acts and contracts of their

[1] Second Ave. R. R. Co. v. Coleman, 24 Barb. (N. Y.) 300 (1857).

[2] Parmelee v. Asso. Physicians, 9 Misc. (N. Y.) 458 (1894); Craft v. South Boston Railroad Co., 150 Mass. 207 (1889); Alexander V. Cauldwell, 83 N. Y. 480 (1881); Bank v. Lumber Co., 116 N. C. 827 (1895).

agents done and made within the scope of their authority."[3]

This statement is subject to the common law rules of agency that an agent exercising the powers usually pertaining to his position binds his principal even though he has exceeded his real power, if the party dealt with is unaware of the agent's lack of the usual authority; and that the continued exercise of certain powers by the agent, if acquiesced in by his principal, will estop him from denying the agent's authority. In other words, the treasurer may be empowered by custom, by implication or by usage as effectively and as absolutely as if authorized by an express enactment.[4]

Thus the treasurer of a corporation might receive and receipt for moneys due the corporation and the debt would be discharged if the payment were made in good faith, even though the right to receive and receipt for the corporate funds had been taken from the treasurer and conferred upon some other corporate official.[5] Of if the treasurer has been accustomed to discount the corporate notes, it is entirely safe to deal with him in any such matter, as the corporation could not in the case of some particular note, deny the treasurer's power and refuse to abide by and be bound by his action. So also in matters entirely outside the treasurer's ordinary duties. If he has been accustomed to act and his acts have been known to the board of directors and have been approved by them, or have not been denied by them, he acquires authority thereto as a matter of usage and his acts therein are binding upon the corporation.[6]

It may be noted that in Massachusetts it is held that the treasurer of a trading or manufacturing corporation has authority by virtue of his office and without other authorization,

[3] Angell & Ames on Corps., § 297.

[4] Chicago Fire Co. v. Chicago Nat. Bk., 176 Ill. 224 (1898); Fifth Ward Sav. Bk. v. First Nat. Bk., 48 N. J. L. 513 (1886).

[5] See § 49.

[6] Phillips v. Campbell, 43 N. Y. 271 (1870); Moore v. Gaus, etc. Co., 113 Mo. 98 (1892).

to make, accept, endorse, issue and negotiate notes and drafts.[7] This rule is unusual, not obtaining in any other state of the Union.

§ 21. Acquiescence or Ratification.

If the treasurer acts beyond his specific authority, and such act is known to the directors of the corporation and is not denied by them, the corporation is bound. A disavowal, to be effective, must be prompt. Otherwise the board is estopped by its apparent acquiesence and cannot come in after the transaction has been consummated and repudiate the act of its agent as unauthorized.[8]

Also in any case where the board accepts the proceeds or benefits of the otherwise unauthorized action of the treasurer, it is held to thereby ratify the transaction and cannot deny or rescind it thereafter. The directors might, if they desired, disavow the act and refuse to receive its benefits and the corporation would not then be bound and could not be held responsible in any way for the treasurer's unauthorized act. When, however, the directors accept the advantages to be derived from an unauthorized action of the treasurer, they have committed the corporation, and they cannot thereafter take refuge behind the treasurer's lack of authority, but must abide the consequences of the ratification involved in their acceptance.[9]

Also a corporation may expressly ratify and confirm actions taken by the treasurer outside the line of his regular duties and the corporation is then bound as firmly as if such actions had been authorized in advance. In other words, ratification after an act is as effective and binding upon the

[7] Merchants' Bk. v. Citizens' Gas Light Co., 159 Mass. 505 (1893); Lester v. Webb, 83 Mass. 34 (1861).

[8] St. James Parish v. R. R., 141 Mass. 500 (1886); Darst v. Gale, 83 Ill. 136 (1876); Washington Sav. Bk. v. Butchers & Drovers' Bk., 107 Mo. 133 (1891); Indianapolis Rolling Mill v. St. Louis, etc. R. R., 120 U. S. 256 (1886).

[9] Insurance Co. v. McCain, 96 U. S. 84, 86 (1877); Taylor v. Navigation Co., 105 N. C. 484 (1890); McKenzie v. Poorman Silver Mines of Colo., 88 Fed. Rep. 111 (1898); Jacksonville, etc. Co. v. Hooper, 160 U. S. 514 (1896).

corporation as authorization before the act, or as expressed in an early New York case, " The averment that an agent acted by due authority is sustained by proof of subsequent ratification." This rule applies not only to the treasurer but to all other officers and agents of the company.[10]

§ 22. Statutory Provisions.

As already stated, statutory provisions referring specifically to the treasurer are found in a comparatively limited number of states and but few of these provisions refer to his powers and duties. The most common provision of this kind is the requirement that the treasurer shall make, or join with other officials in making certain specified statutory reports. In some few states, as in New Jersey, he must, with some other officer, sign stock certificates. In Ohio, North Dakota and some other states, the corporation is required by statute to keep books of account. In Pennsylvania the treasurer must keep the moneys of the corporation in a separate book account to his credit as treasurer.[11]

It may be stated, broadly speaking, that the statutes do not in any case define the specific duties of the treasurer beyond such few and rather general requirements as those referred to in the preceding paragraph. The whole matter is left almost entirely to the discretion of the corporation.

§ 23. Charter Provisions.

In most states of the Union provisions relating to the powers and duties of the treasurer must be incorporated in the charter. In some few states, as in New York and New Jersey, the statutes permit special charter provisions and any desired specifications as to the treasurer's duties and powers, or any other matters of corporate management may be embodied therein.

[10] Hoyt v. Thompson, 19 N. Y. 207 (1859).

[11] Laws of 1874 (Pa.), Act 32, § 9.

The insertion of charter provisions prescribing the duties of the treasurer is, however, unusual even in the states where they are permitted. Such regulations properly belong in the by-laws and the only object of bringing them into the charter would be to secure the permanence characteristic of charter provisions on account of the difficulty of changing them. Usually this permanence is not desired, so that even in those states where special charter provisions are permitted, the requirements referring to the treasurer's duties are almost invariably found in the by-laws.

§ 24. By-Law Provisions.

In many states the statutes specifically provide that the powers, duties and qualifications of the corporate officials either shall or may be stated in the by-laws. These statute provisions when permissive merely restate a power already possessed by the corporation.

In practice the by-laws are almost invariably the source from which come both the powers and the duties of the treasurer. Under these circumstances an inspection of the by-law provisions of the better modern corporations relating to the treasurer, will give a clear and comprehensive view of his powers and duties that could hardly be obtained in any other way. For this reason the following chapter of the present volume is devoted entirely to the consideration of by-law provisions relating to the treasurer.[12]

By-law provisions are superior in authority to directors' resolutions and are not usually subject to change at the hands of the directors. They may, however, ordinarily be amended or repealed by the stockholders at any annual meeting, or at any special meeting called for the purpose, the by-laws themselves usually providing the procedure for repeal or amendment. In short, while by-law provisions may be amended without undue difficulty or serious delay, they have a reason-

[12] Chap. IV; see also § 6.

able stability and are not subject to sudden or unpremeditated change and therefore offer a peculiarly suitable medium for the expression and regulation of the treasurer's duties.

§ 25. Directors' Resolutions.

In the care and management of the corporate funds and for the discharge of any duties connected therewith, the treasurer is the active agent of the corporation, and of its governing body, the board of directors.[13] He is therefore subject to the direction of this board in all such matters, except in so far as his powers and duties have already been prescribed by higher authority.

If no provisions as to the powers and duties of the treasurer are found in the charter or by-laws of the corporation, the directors, as an incident of their general control of the corporate affairs, are fully competent to determine these powers and duties and to authorize him to their performance.[14]

If, however, charter or by-law provisions exist defining and fixing the powers and duties of the treasurer, these cannot ordinarily be disturbed by the directors. They have no power to modify charter provisions, neither can they ordinarily repeal or modify by-law provisions. If, then, the scope of the treasurer's powers and duties has been fixed by either of these authorities, the directors may neither deny nor interfere. They can, however, amplify and supplement as may be necessary.

As a rule, the by-laws prescribe the powers and duties of the treasurer with more or less detail. The directors then adopt only such supplementary or additional rules as may be necessary to guide the treasurer or to expedite the business of the corporation.

For instance, the by-laws usually provide that the corporate funds shall be deposited in some bank to be designated

[13] See also § 7.

[14] Beveridge v. N. Y. E. R. Co., 112 N. Y. 1 (1889); Park v. Grant Locomotive Works, 40 N. J. Eq. 114 (1885); Saltmarsh v. Spaulding, 147 Mass. 224 (1888); Leslie v. Lorillard et al, 110 N. Y. 519 (1888).

by the board of directors. Also they usually state that books of account shall be kept, and perhaps provide for certain reports to be made by the treasurer. The directors cannot change these provisions, but, supplementing them, they will designate the particular bank in which the funds are to be deposited, prescribe what books are to be kept and what reports shall be made by the treasurer. Also in the absence of specific by-law provisions, they might decide the signature to checks on which the corporate funds are to be drawn out and also specify in what form and by whom checks are to be endorsed for deposit, and prescribe any other working details that might be necessary and not in conflict with the by-law provisions.

In some few states the directors either have power under the statutes to make and alter by-laws, or may be given such power by the corporation itself. When this is the case the directors are enabled thereby to exercise an unusually complete and unquestioned control over the corporate officials.

The action of the board of directors may be expressed either in the form of a motion or a resolution. There is no distinct line of demarcation between these two. They are both the expressions of the decisions or wishes of the board. The motion is the simpler in form and usually the briefer. The resolution is more formal. A short resolution without any preamble might, however, correctly be styled a motion and a motion might easily be amplified into a resolution. The legal force of the two is the same.[15]

It may be said in passing that where the management of the corporation has, by statute, charter or by-law provision, been vested in the directors, the stockholders have no right to direct the action of the treasurer or of the other corporation officials in any way, save through the medium of the by-laws. Under such circumstances, stockholders' motions or resolutions instructing the treasurer or fixing his duties, would be abso-

[15] Goodwin, etc. v. U. S. Annuity & L. I. Co., 24 Conn. 591 (1856); Ten Eyck v. Railroad Co., 74 Mich. 226 (1889).

lutely ineffective, even though passed by the unanimous vote of every stockholder of the company.[16] Should the treasurer obey such a motion or resolution in opposition to the mandates of the board or to a requirement of the by-laws, he would be entirely at fault and subject to removal for disregard of the proper authority.

§ 26. The Treasurer's Authority for Action.

The treasurer is expected to inform himself as to the powers conferred upon him by the charter and by-laws. When resolutions or motions are passed affecting him, it is the secretary's duty to call them to his attention. Usually this is done very informally. If the treasurer is a member of the board of directors, his mere presence when the resolution or motion is passed suffices without further notice. If not present, a verbal notification by the secretary is ordinarily deemed sufficient, though if some action of importance is to be taken by the treasurer, a formal written notice of the authorizing resolution should be given him.

As to outside parties, notice of the treasurer's authority for acts he performs will vary according to the conditions and the importance of his action. If the act is one within the usual range of his duties, and such as he customarily performs, his authority will rarely, if ever, be questioned. Where, however, some specific action of importance is to be taken by the treasurer, and particularly when this is outside the usual line of his duties, formal evidence of his authority is ordinarily and properly required by those with whom he deals.

In matters of small moment, the treasurer's authority if questioned, might be substantiated by a mere reference to the by-laws, or by an uncertified copy of the motion or resolution under which he is acting. Where the matter is important, a certified copy of his authorization is properly required.

In any such case the secretary must be called upon for the

[16] Smith v. Hurd, 12 Metc. (Mass.) 371, 385 (1847).

required evidence of authority. This is usually a copy of the empowering by-law or resolution, the authenticity of the original, and the correctness of the transcript being duly certified by the secretary under the seal of the corporation. Sometimes in matters of special importance the president of the company will join with the secretary in the certification. These certified copies of enabling by-laws and resolutions are the customary form in which official authority is evidenced and are of frequent use.[17]

§ 27. Place of Action.

The usual place in which the treasurer's duties are performed and his powers are exercised, is the office of the corporation. The law does not, however, circumscribe his powers to any one place. When properly representing the company in the discharge of his duties, his acts are as valid in one place as another and equally binding upon the corporation. When duly authorized thereto, he may sign a corporate check or contract in his office, or in another state with equal validity. The whole matter is one of authority and not of the place in which the authority is exercised.[18]

[17] See "Forms," Chap. XXXIV.

[18] Hastings v. Ins. Co., 138 N. Y. 473, 479 (1893).

CHAPTER IV.

BY-LAW PROVISIONS AFFECTING TREASURER.

§ 28. General.

In practice the important powers and duties of the treasurer are almost invariably found in the by-laws. These by-law provisions should be comprehensive and at least reasonably detailed, though, as it is expected that they will be supplemented by the directors, they should not go too far into minor detail of procedure. These are better left to the directors to be determined by the conditions and to be changed as the conditions change. Beyond this the directors will deal with any special duties of the treasurer and with those incidental to the powers and duties of the by-laws.[1]

Different sets of by-laws have been drawn upon for the provisions which follow. All of these apply directly to the treasurer, varying somewhat as to the duties conferred, but differing mainly as to comprehensiveness. They will serve to indicate the function and scope of the by-laws as to official duties.

The provisions as to the finance committee and the auditor found in the sets of by-laws quoted from, also bear with some directness on the powers and duties of the treasurer. These have, however, been omitted from the present chapter since they are given elsewhere. (See Chap. V.)

§ 29. Brief Provisions.

The following provisions are taken from a short set of by-laws which has been found very satisfactory in practice.

[1] See §§ 6, 24.

They are intended to cover the powers and duties of the treasurer in a general way only, leaving much to the judgment of the board and even more to the discretion of the treasurer. The first extract is taken from Article IV, "Officers" and reads as follows:—

> "The Treasurer shall have the custody of all moneys and securities of the Company and shall keep regular books of account and balance the same each month. He shall sign or countersign such instruments as require his signature, shall perform all duties incident to his office or that are properly required of him by the Board, and shall give bond for the faithful performance of his duties in such sum and with such sureties as may be required by the Board of Directors."

This lacks the specific details found in some of the more complete by-law provisions given later in the present chapter. It is, however, sufficient for the needs of a small corporation in which the directors are in close, personal touch with the corporate officers and the corporate affairs and where the absence of detail in the by-laws is not only unobjectionable but is even advantageous.

In a small or close corporation it is not always necessary or expedient to exact a bond of the treasurer, and the requirement should then be omitted from the by-laws or be so worded as to make its enforcement discretional with the directors. This is better than to include the provision and allow it to stand as a dead letter.

In the same by-laws under Article V, "Dividends and Finances," is found the following provision, also relating directly to the duties of the treasurer:—

> "The moneys of the Company shall be deposited in the name of the Company in such banks or trust companies as the Board of Directors shall designate, and shall be drawn out only on check signed by the Treasurer and countersigned by the President."

This requires specifically that the bank account shall be in the name of the company and not in the name of the treasurer, a practice not uncommon but liable to cause trouble.

The following corresponding provisions relating to the treasurer are taken from another short but satisfactory set of by-laws:—

> "Sec. 6. The Treasurer shall keep accurate records of all moneys received and paid out and shall have the custody of all property. All funds shall be paid out as directed by the Board of Directors and the Treasurer shall make reports of the financial condition of the company when required. He shall give such bond as the Board of Directors may require for the faithful discharge of his duties."
>
> "Sec. 14. All checks for the payment of money must be signed or countersigned by the President."

As will be noted, under these by-laws the treasurer is not specifically required to keep the books of account, but merely to keep a record of all moneys received and paid out,—in other words, a cash book. If, then, the treasurer is to be the general accounting officer of the corporation, his duties as such must be prescribed by the directors, and his authority as such will be derived entirely from them.

It will also be noted that the signature of checks is but partially prescribed. The signature of the president must appear upon the check but whether as the main signature or merely as a countersignature, is left to the discretion of the board. The signature of the treasurer is not mentioned at all, but would appear on the corporate checks as a matter of course, unless otherwise prescribed by the directors. In this, as in every other matter not covered by the by-laws of the company or some other superior authority, the treasurer is subject to the instructions of the directors.

The broad provision that the treasurer shall have "the custody of all property" is unusual as to wording and doubtful as to wisdom. The omission of specific reference to the corporate funds or moneys is perhaps immaterial. They would be covered by the language used. The sweeping disposal of the corporate possessions is a more serious consideration. Conditions might well arise in which some portions at least of the corporate property would be better or more conveniently held in the hands of other officials. Under this by-law, however, no matter what the conditions, the directors could not legally take the custody of the corporate property away from the treasurer.

In the more complete and cautious by-law provisions which follow the treasurer is given no such power. Only the funds and securities of the company are placed in his charge and even this trust is modified by the provision "except as otherwise directed by the Board of Directors."

§ 30. Extended Provisions.

The provisions of the present section are taken from more complete sets of by-laws than those heretofore presented and naturally go more fully into the detail of the treasurer's duties.

The provisions which immediately follow appear under the general head of "Officers."

> "Sec. 5. *The Treasurer.*
>
> "The Treasurer shall have the custody of and be responsible for all moneys and securities of the Company; shall keep full and accurate records and accounts in books belonging to the Company, showing the transactions of the Company, its accounts, liabilities and financial condition, and shall see that all expenditures are duly authorized and are evidenced by proper receipts and vouchers. He shall deposit, in the name of the Company, in such depositary or depositaries as are approved by the Directors, all moneys that may come into his hands for the Company account. His books and accounts shall be open at all times during business hours to the inspection of any Director of the Company.
>
> "The Treasurer shall also endorse for collection or deposit all bills, notes, checks and other negotiable instruments of the Company; shall pay out money as may be

> necessary in the transactions of the Company, either by special or general direction of the Board of Directors, and on checks signed by the President and himself, and shall generally, together with the President, have supervision of the finances of the Company.
>
> " He shall also make a full report of the financial condition of the Company for the annual meeting of the stockholders, and shall make such other reports and statements as may be required of him by the Board of Directors or by the laws of the State.
>
> " He shall give bond in the sum of five thousand dollars, with sureties satisfactory to the Board of Directors, for the faithful performance of his duties and for the restoration to the Company, in event of his death, resignation or removal from office, of all books, papers, vouchers, money and other property belonging to the Company that may have come into his custody. He shall receive such compensation, not exceeding eighteen hundred dollars per annum, as may be fixed by the Board of Directors."

By these provisions the treasurer is given entire custody and charge of the corporate moneys and securities, though not of the general property belonging to the company. His duties are also enumerated in some detail and with protective reservations. The books of account must be the property of the company, funds must be deposited in the corporate name, all expenditures must be duly authorized and evidenced, the general signature to checks is prescribed and the amount of his bond and the maximum amount of his compensation are specified. It is also stipulated that his bond shall cover the due return to the company of all corporate property in his hands.

In the same set of by-laws under the general heading of " Finance," the subject of bank deposits is covered as follows:—

> " Sec. 4. *Bank Deposits.*
>
> " The Treasurer shall deposit the moneys of the Company, as the same may come into his hands, in such depositary or depositaries as may be designated by the Board of Directors, and such deposits shall be made in

> the name of the Company, and moneys shall be withdrawn therefrom only by check signed by the Treasurer and countersigned by the President."

This is practically a repetition of requirements appearing in the section already quoted. The repetition is justified by the general importance of the subject, and as a matter of convenience and prudence as well. As will be noted, the signature of the checks by which the treasurer disburses the company funds is again, but more particularly specified; also the treasurer is again required to deposit the corporate moneys in the name of the company as they come into his hands, and in such depositary or depositaries as may be designated by the board of directors. No question could arise under these very explicit provisions as to the disposition and method of disbursing the corporate funds, except possibly through the failure of the board to designate a depositary. In such case the treasurer would undoubtedly have authority to deposit the funds in such suitable bank or banks as he himself might select and to continue so to do until a depositary was designated by the board. Such temporary deposits would, of course, be made in the company name.

In another very excellent set of by-laws fairly equal in comprehensiveness to those already quoted from, are found the following provisions relating to the treasurer and his duties.[2]

"*ARTICLE XII.—TREASURER.*

> "Sec. 1. The Treasurer shall keep full and accurate accounts of receipts and disbursements in books belonging to the Company, and shall deposit all moneys and other valuable effects in the name and to the credit of the Company in such depositaries as may be designated by the Board of Directors. He shall have the authority to endorse on behalf of the Company for the purpose only of transfer to the depositary bank or trust company, to be

[2] Heath's Maine Laws, pp. 159, 160.

> deposited therein, all checks, notes, drafts, warrants and orders.
>
> " Sec. 2. He shall disburse the funds of the Company as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the President and Directors, at the regular meetings of the Board, or whenever they may require it, an account of all his transactions as Treasurer and of the financial condition of the Company, and at the regular meeting of the Board next preceding the annual meeting of the stockholders a like report for the preceding year.
>
> " Sec. 3. The stock books, stock transfers and stock records shall be kept at the office of the Treasurer and in such form and manner and under such regulations as the Board of Directors may determine.
>
> " Sec. 4. The Treasurer shall give the Company a bond in a sum, and with one or more sureties satisfactory to the Board of Directors, for the faithful performance of the duties of his office, and the restoration to the Company, in case of his death, resignation or removal from office, of all books, papers, vouchers, money or other property of whatever kind in his possession belonging to the corporation."

As will be noted, these provisions are even more cautious than those of the preceding by-laws. The treasurer's authority to endorse is restricted, the books of account must be the property of the company and the stock transfers and stock records—which are usually within the province of the secretary—are to be kept in the office of the treasurer and in the form and manner prescribed by the board.

In the same by-laws under Article XIV, " Certificates of Stock," it is provided as follows:—

> " Sec. 1. All certificates of stock shall be signed by the President or Vice-President and by the Treasurer and shall have affixed thereto the corporate seal."

More commonly, except in those few states where the treasurer is required by statute to join in the signing of stock certificates, the secretary is designated as the officer to join with the president in signing stock certificates.

In the same by-laws, Article XVI, "Contracts, Checks, Notes, Etc.," are found the following provisions:—

> "Sec. 2. All checks, drafts or orders for the payment of money shall, until the Directors otherwise order, be signed by the Treasurer. No check shall be signed in blank.
>
> "Sec. 3. All notes and acceptances shall, unless the Directors otherwise order, be signed by the President, or Vice-President, and the Treasurer."

Here the treasurer alone signs the company checks. Apparently this is a departure from the cautious provisions characteristic of this set of by-laws. The wisdom of placing the company funds unreservedly in the hands of the treasurer is more than doubtful. Almost invariably, a second signature or countersignature is required so as to make disbursements of the company funds impossible save with the knowledge and formal concurrence of at least two officials of the corporation.

The power of the treasurer over disbursements is, however, qualified in the present provision by the phrase, "until the Directors otherwise order." Under this sweeping proviso the directors have absolute power to change the signature to the company checks, drafts and orders at discretion. They might, if they thought proper, require one or more additional signatures or might even take away from the treasurer entirely the power to sign checks. Without this clause the directors would, however, under the wording of the provision quoted, still have had power to require a countersignature on the company's checks. They could not have denied the treasurer's power to sign checks but could supplement this provision by requiring a countersignature.

The provision prohibiting the signing of checks in blank is unusual and hardly necessary. Emergencies might on rare occasions arise where such a proceeding would be justified.

Otherwise it is too obviously improper to require express prohibition.

§ 31. Comprehensive Provisions. First Set.

In the by-laws of the larger corporations it is usually though not invariably the case that the powers and duties of the treasurer are specified in much detail. The provisions relating to the treasurer given in this and the following section are of this nature.

In the carefully drawn and comprehensive set of by-laws from which the following articles are taken, the statement of the powers and duties of the treasurer is somewhat exhaustive.

> " *ARTICLE V.—OFFICERS.*
>
> " Sec. 7. *The Treasurer.*
>
> "The Treasurer shall be the custodian of the funds and securities of the Company, except as otherwise directed by the Board of Directors, and shall be responsible for all moneys and other property of the Company under his charge; he shall keep full and accurate records and accounts, in books belonging to the Company, of all receipts, disbursements, credits, assets, liabilities and general financial transactions of the Company; he shall deposit all moneys and other valuable effects of the Company coming into his hands in such depositaries as may be designated by the Board of Directors or by the Finance Committee. His books and accounts shall be open at all times during business hours to the inspection of any Directors of the Company.
>
> " He shall disburse the funds of the Company as may be ordered by the specific or general instructions of the Board of Directors or the Finance Committee, taking proper vouchers for all such disbursements; he shall endorse for collection or deposit all bills, notes, checks and other negotiable instruments of the Company, and deposit the same to the Company's credit; he shall sign all receipts and vouchers for payments made the Com-

pany, and shall jointly with such other officer as may be designated by the Finance Committee, sign all checks made by the Company; he shall sign, with the President, or with such other person or persons as may be designated for the purpose by the Board of Directors oı Finance Committee, all bills of exchange, promissory notes and bonds of the Company, and shall sign with the President, or with a duly authorized Vice-President, all certificates of shares of the Company's capital stock.

"He shall give bond to the Company in such sum, and with such sureties, and in such form, as shall be satisfactory to the Finance Committee, for the faithful performance of the duties of his office, and for the restoration to the Company, in the event of his death, resignation or removal from office, of all books, papers, vouchers, money and other property of whatever kind in his custody and belonging to the Company.

"He shall render to the Directors and to the Finance Committee, as called for, all such statements and accounts as may be required of him; shall prepare an annual report showing the financial condition of the Company on the 31st day of December in each year, which report when made shall be presented to the next succeeding meeting of the Board of Directors and to the annual meeting of stockholders; and shall make such other reports and do such other things incidental to his position as may be required of him by the Board of Directors or by the Finance Committee."

This leaves but little to be said. As it will be noted, however, the treasurer is carefully subordinated to the authority of the board of directors and of the finance committee in almost every detail of his duties.

In the same by-laws assistant treasurers are provided for as follows:—

"Sec. 8. *The Assistant Treasurer.*

"The Assistant Treasurer, when appointed, shall, in the absence, the inability, the neglect or refusal to act of the Treasurer, be vested with all the powers and be required to perform all the duties of that official. At other

> times he shall assist the Treasurer in the discharge of his duties, and shall do such other things incidental to the position as may be directed by the Board of Directors or Finance Committee. He shall give bond to the Company in such amount and in such form and with such security as may be prescribed by the Finance Committee.
>
> " Should other Assistant Treasurers be appointed by the Board, they shall have such powers and perform such duties connected with the financial administration of the Company as may be assigned to them by the Board of Directors or the Finance Committee, and the Directors shall have power to assign to any such assistant official such of the powers and duties of the Treasurer as may in their judgment be necessary or expedient."

Under the head relating to " Dividends and Finances " is found the following provision :—

> " Sec. 3. *Depositaries.*
>
> " The Finance Committee or the Board of Directors shall from time to time designate the depositaries of the Company, and the Treasurer of the Company shall deposit the Company funds therein, in the name of the Company, in such manner and amounts as may be prescribed."

Under this provision, the treasurer's signature must appear on the company checks, but a countersignature is to be prescribed by the finance committee. Also the " manner and amounts " of the company deposits are to be prescribed either by the directors or by the finance committee.

§ 32. Comprehensive Provisions. Second Set. (U. S. Steel Corporation.)

The following provisions relating to the treasurer are taken from the by-laws of the United States Steel Corporation (Article V, Section 1), only those relating more or less directly to the treasurer being given :—

> " The executive officers of the Company shall be a chairman of the Board of Directors, a president, a vice-

> president, or more than one vice-president, a general counsel, a treasurer, a secretary and a comptroller, all of whom shall be elected by the Board of Directors."
>
> "All officers and agents shall be subject to removal at any time by the affirmative vote of a majority of the whole Board of Directors."
>
> "Each of the salaried officers of the corporation shall devote his entire time, skill and energy to the business of the corporation, unless the contrary is expressly consented to by the Board of Directors or the Finance Committee."
>
> "The Finance Committee shall have power to remove all officers, agents and employees of the Company, except officers elected or appointed by the Board of Directors."

Section 9 of Article V also provides:—

> "The offices of Secretary and of Treasurer may be held by one and the same person."

The power of control, suspension and removal given to the directors and finance committee by the preceding provisions, is sweeping and unrestricted. The provision permitting the offices of secretary and treasurer to be united in one person is not often found in the by-laws of the larger corporations.

In Article VI, "Capital Stock—Seal," the following provision is found:—

> "The certificates shall be signed by the president or a vice-president, and also by the treasurer or an assistant treasurer."

This same provision is found in a slightly different form in Sections 4 and 7. In practice the stock certificates of the United States Steel Corporation are usually signed by a vice-president and an assistant treasurer of the company.

The provisions more directly defining the powers and duties of the treasurer are found in Section 7 of Article V, reading as follows:—

> "Section 7. *Powers and Duties of Treasurer.* The treasurer shall have custody of all the funds and securities

> of the Company which may have come into his hands; when necessary or proper he shall endorse on behalf of the Company, for collection, checks, notes and other obligations, and shall deposit the same to the credit of the Company in such bank or banks or depositary as the Board of Directors or the Finance Committee may designate; he shall sign all receipts and vouchers for payments made to the Company; jointly with such other officer as may be designated by the Finance Committee, he shall sign all checks made by the Company, and shall pay out and dispose of the same under the direction of the Board or of the Finance Committee; he shall sign with the president, or such other person or persons as may be designated for the purpose by the Board of Directors or the Finance Committee, all bills of exchange and promissory notes of the Company; he may sign, with the president or a vice-president, all certificates of shares in the capital stock; whenever required by the Board of Directors or by the Finance Committee, he shall render a statement of his cash account; he shall enter regularly, in books of the Company to be kept by him for the purpose, full and accurate account of all moneys received and paid by him on account of the Company; he shall, at all reasonable times, exhibit his books and accounts to any director of the Company upon application at the office of the Company during business hours; and he shall perform all acts incident to the position of treasurer, subject to the control of the Board of Directors or of the Finance Committee.
>
> " He shall give a bond for the faithful discharge of his duties in such sum as the Board of Directors or the Finance Committee may require."

As will be noted, the treasurer is again carefully subordinated to the board of directors and to the finance committee. He is still further held in check by the provision already quoted, subjecting him to removal without cause at the pleasure of the directors. Under such circumstances, it is not probable that the treasurer will lightly oppose the wishes or instructions of the directors.

In the main the powers conferred on the treasurer of the

United States Steel Corporation are merely the usual powers. It is required that "he shall sign all checks made by the Company, and shall pay out and dispose of the same under the direction of the Board or of the Finance Committee." In Section 4 of the same article, the president also is given power to sign any authorized checks of the corporation, presumably in connection with the treasurer. These provisions do not, however, in any way restrict the board or the finance committee from requiring such countersignatures on checks as they may deem necessary.

In Section 8 of Article V, provision is made for assistant treasurers as follows:—

> "Section 8. *Assistant Treasurers.* The Board of Directors or the Finance Committee may appoint an assistant treasurer or more than one assistant treasurer. Each assistant treasurer shall have such powers and shall perform such duties as may be assigned to him by the Board of Directors, or by the Finance Committee."

CHAPTER V.

THE FINANCE COMMITTEE.

§ 33. Standing Committees.

In the larger corporations it is customary to appoint one or more permanent or so-called standing committees composed of members of the board of directors, and to delegate to them a considerable measure of the power of the board. In the intervals between the directors' meetings these committees usually exercise all the powers of the board itself. The purpose of standing committees is two-fold. (1) As their membership is usually restricted, they can act with a promptness and efficiency impossible to a large board of directors. (2) As their powers are usually unrestricted, they obviate the necessity for frequent meetings of the board.

In the smaller corporations, standing committees are but seldom necessary or desirable. In the larger corporations, however, where the board of directors is usually so large as to be unwieldy, they are convenient and effective and are almost invariably employed.

By proper charter or by-law provision, as many standing committees may be created as is desired, though it is rare that more than two are deemed necessary. If but one committee exists, it is usually termed the "Executive Committee," and this committee is given supervision of the financial affairs of the corporation as part of its duties. If two committees are appointed, the second, usually termed the "Finance Committee," is given direct supervision of the corporate finances, while all general matters remain in charge of the executive committee. When a finance committee exists, the treasurer reports and is responsible to that committee; otherwise to the executive committee.

"These standing committees appointed with such powers are the real managing bodies of the corporation, the board merely receiving their reports and supervising their operations. They usually act and then report their action to the board. In some cases where they prefer to throw responsibility upon the board, or where some statute provision requires action of the board, or when it is desirable to lend added weight to some contemplated measure, the committee will report the matter to the board with a recommendation that the desired action be taken."[1]

§ 34. Appointment of Finance Committee.

"The standing committees are usually created and empowered and the manner of their appointment or election is prescribed by charter or by-law provisions. Since the powers of the board are to a greater or less degree to be delegated to these committees they must be composed of members of the board. The provisions as to their appointment are therefore confined to the manner of their selection from this body. Sometimes the creating provision will provide that certain officials of the board shall form the standing committees, as for instance that the president, vice-president and treasurer shall constitute the executive committee. The treasurer if a director is designated as a member of the finance committee almost as a matter of course. Also it is quite usual to provide that the president of the company shall *ex officio* be a member of the executive committee and sometimes it is provided that he shall be a member, and the presiding officer of all standing committees. At times it is provided that the president shall appoint the different standing committees. The most common,

[1] Conyngton on Corp. Org., § 163.

and perhaps the safest plan, leaves the membership of these committees to be decided by an election in the board."[2]

When standing committees are to form part of the corporate mechanism, their appointment is usually prescribed by charter provision. The details of appointment and of their duties and procedure thereafter may also be fixed by the same authority, but are better left for the by-laws. Frequently the charter will merely prescribe that standing committees shall or may be appointed, leaving all details to the by-laws and to the board.

For instance, the charter of the United States Steel Corporation specifically authorizes the board of directors to appoint an executive and other standing committees, as follows:—

> "The Board of Directors, by the affirmative vote of a majority of the whole Board, may appoint from the Directors an executive committee, of which a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committee shall have and may exercise all or any of the powers of the Board of Directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.
>
> "The Board of Directors, by the affirmative vote of a majority of the whole Board, may appoint any other standing committees, and such standing committees shall have and may exercise such powers as shall be conferred or authorized by the by-laws."

In the by-laws of the United States Steel Corporation as originally adopted, an executive committee was provided for with specified powers. Since that time, however, the by-laws have been so amended as to eliminate this committee. Practically it has been merged into the finance committee which is given broad and general powers rarely conferred upon a finance committee. It occupies in fact the position usually accorded the executive committee and is the only standing com-

[2] Conyngton on Corp. Org., § 164.

mittee with any real powers found in the organization of the corporation.

The appointment of the finance committee is authorized and directed in Article III, Section 1 of the by-laws in the following provision:—

> "The Board of Directors shall elect from the directors a *Finance Committee,* and shall designate for such committee a chairman, who shall continue to be chairman of the committee during the pleasure of the Board of Directors."

Also in Section 2 of the same article, the membership of the finance committee is prescribed as follows:—

> "*The Finance Committee* shall consist of seven members, besides the chairman of the Board and the president, each of whom, by virtue of his office, shall be a member of the Finance Committee."

These by-law provisions are mandatory, requiring the board to appoint a finance committee and restricting its membership to members of the board,—a restriction also found in the charter and a mere restatement of the common law. The number is limited—if the term is properly used in connection with so large a committee—to nine members, two *ex officio* members, i. e. the chairman of the board and the president of the corporation, and seven elective members.

This plan of appointment, whereby the committee is constituted in part of *ex officio* members –of whom the president of the company is always one—and in part of members directly elected by the board, generally prevails. Thus in the by-laws quoted from in the preceding chapter,[3] we find the following provisions relating to the appointment of the finance committee:—

> "There shall be a Finance Committee of three or more members as may be determined by the Board of Directors, consisting of the President of the Company and

[3] Chap. IV, § 30.

> of two or more other members, to be chosen annually by the Board of Directors from their own number, at the first meeting of the Board after the annual meeting of the stockholders or as soon thereafter as may be convenient."

Under this provision the finance committee must be composed of at least three members and may have as many more as the board sees fit, up to the total membership of the board of directors itself. In practice, however, the membership of the committee is always small. A finance committee composed of nine members as in the United States Steel Corporation is very unusual, the membership of such committees rarely exceeding five. It is obvious that a large membership would defeat the very purpose for which the committee was appointed.

Vacancies in the standing committees are filled in the manner prescribed by the by-laws or other creating provisions. The by-laws just quoted from provide in a later clause that vacancies in the finance committee shall be filled for the unexpired term by the remaining members of the committee, subject to the approval of the board of directors at its next meeting. In the United States Steel Corporation, however, all vacancies in the finance committee are filled by the board of directors. This would seem the preferable plan.

As the finance and executive committees usually exercise discretionary powers which belong to the board of directors, their membership must, as already stated, be confined to the membership of the board. If it is not so confined, the power of the board to delegate its authority to the resulting committees, composed in whole or in part of members who are not directors, is questionable, and as a consequence the action of such committees, if not absolutely illegal, would be of doubtful validity. When the committees are properly constituted, however, the board has undoubted power to delegate to them all the authority it possesses, unless such delegation is expressly prohibited by statute or by charter provision.[4]

[4] Sheridan E. L. Co. v. Bank, 127 N. Y. 517 (1891); Jones v. Williams, 139 Mo. 1 (1897); Union Pacific Ry. Co. v. Chicago, etc. Ry. Co., 163 U. S. 564 (1896); Burrill v. Nahant Bank, 43 Mass. Rep. 163 (1840); contra, Weidenfeld v. Sugar Run R. Co., 48 Fed. Rep. 615 (1892).

As far as permitted by the limitation to the membership of the board, the members of the finance committee will naturally be selected on the basis of qualification. In the by-laws of the United States Steel Corporation it is specified:—

> "So far as practicable each of the seven elected members of the Finance Committee shall be a person of experience in matters of finance. Unless otherwise ordered by the Board of Directors, each elected member of the Finance Committee shall continue to be a member thereof until the expiration of his term of office as a director." (By-laws, Art. III, § 2.)

This same rule as to qualifications should obtain, as a matter of course, in the appointment of any finance committee, those members of the board being selected whose experience or standing in financial matters best qualifies them for its work.

§ 35. Organization of Finance Committee.

There is no general rule as to the internal organization of the finance committee—that is, as to its officers and the manner of their appointment or election. In some cases the committee officers are designated by the charter or by-law provisions which authorize or create the committee; in others, they are elected by the board of directors, while in many cases the selection of its officers is left to the committee itself.

Generally the officers of the committee are a chairman and a recording secretary. Other officials may be appointed but are not usually either necessary or desirable. In the absence of any special reason to the contrary, it would seem proper that the president of the company, who is almost invariably *ex officio* a member of the committee, should be its chairman. If not otherwise prescribed, the selection of a chairman might well be left to the committee itself.

In the United States Steel Corporation the chairman of the finance committee must be designated by the board of directors (By-laws, Art. III, § 1) but it is expressly provided that the secretary of the corporation shall be the recording officer of the finance committee, unless otherwise directed by the committee itself. (By-laws, Art. V, § 9.)

In any case where no special provision is made for the election or appointment of the officers of the finance committee, the board of directors may either designate such officers or provide the methods of their appointment. If this is not done the committee itself may elect its officials.

§ 36. Action of Finance Committee.

The finance committee acts as does any other parliamentary body. In the by-laws of the United States Steel Corporation it is provided that " The Finance Committee shall fix its own rules of proceeding and shall meet where and as provided by such rules, or by resolution of the Board of Directors, but in every case the presence of at least four members shall be necessary to constitute a quorum." Also " In every case the affirmative vote of a majority of all of the members of the committee present at the meeting shall be necessary to its adoption of any resolution." (By-laws, Art. III, § 1.)

A more detailed statement of the procedure of the finance committee is found in the by-laws previously quoted from,[5] which provide that the committee shall fix its " regulations and rules of procedure, and shall meet where and as provided by such rules or as provided by the resolution of the Board of Directors; but at every meeting a majority of the whole committee shall be necessary to constitute a quorum, and the affirmative vote of a majority of the whole committee shall be necessary for the adoption of any resolution or course of action. Full minutes of the proceedings at committee meetings shall be kept, and reports made to the Board of Directors when requested." This is for the most part merely declaratory of the common or parliamentary law which governs the actions of such a body.

[5] See § 30.

In all matters of procedure not otherwise prescribed, the finance committee has full power to fix its own rules. These should be as few and simple as prudence will permit. The special purpose of the committee is to secure prompt and efficient action in all important matters within its scope, and in pursuance of this its procedure should be, and usually is marked by the absence of all formality that can be safely dispensed with.

Owing to the compactness of the usual finance committee and the manner in which it is constituted, it may be easily assembled. A large proportion of the business of the committee is therefore transacted at special meetings. These special meetings may be held without notice, or other formality if either the consent or the participation of every member is secured, but otherwise, whether so prescribed by the by-laws of the corporation or the rules of the committee or not, they must be duly notified to the membership of the committee. Any action taken at meetings of the committee should be expressed in a duly adopted resolution or motion, and careful records of all proceedings should be kept. The committee proceedings should from time to time be reported to the directors or the minutes in which these proceedings are recorded may be submitted for their information.

Unless otherwise expressly provided, a majority of the finance committee constitutes a quorum and a majority of that quorum has power to act. For instance, if the committee is composed of five members, three of these form a quorum and are competent to act for the committee. Then if only a quorum is present at any meeting, two of these three constitute a majority and may decide any matter before them and thereby bind the committee, the directors and the corporation.[6] To prevent this "minority rule," it may be prudent to require that the affirmative vote of a majority of the whole committee shall be necessary for action.

[6] Burleigh v. Ford, 61 N. H. 360 (1881); State v. Jersey City, 27 N. J. L. 493 (1859); McNeil v. Boston Chamber of Commerce, 154 Mass. 277 (1891).

In a committee composed of three members, this provision is unnecessary as it merely states a condition that already exists. In a committee of five, however, it would necessitate at least three affirmative votes before committee action could be secured.

§ 37. Powers of Finance Committee.

The following by-law provisions define with much clearness the usual scope and powers of the finance committee. They are found under the head of "Standing Committees" in the by-laws quoted from in the preceding chapter:[7]

> "The Finance Committee shall have general and special charge and control of all financial affairs of the Company, and shall have and exercise all of the powers of the Board of Directors in such financial matters when the latter is not in session. The Treasurer and the Auditor of the Company shall be under the direct control and supervision of the Finance Committee.
>
> "The Finance Committee shall fix all salaries and compensation paid or payable to officials of the Company, except as otherwise provided in these by-laws or fixed by resolution of the Board of Directors."

It will be noted that the financial affairs of the company are placed unreservedly in the hands of the committee in the interim between board meetings; also that the treasurer is expressly subordinated to its authority.

In Article III, Section 2 of the by-laws of the United States Steel Corporation we find the following very specific provisions:—

> "The Finance Committee shall have special charge and control of all financial affairs of the Company. The general counsel, the treasurer, the comptroller and the secretary, and their respective offices, shall be under the direct control and supervision of the Finance Committee.
>
> "During the intervals between the meetings of the Board of Directors, the Finance Committee shall possess, and may exercise, all the powers of the Board of Directors

[7] Chap. IV, § 30.

> in the management of all of the affairs of the Company, including its purchases of property, and the execution of legal instruments with or without the corporate seal in such manner as said committee shall deem to be best for the interests of the Company, in all cases in which specific directions shall not have been given by the Board of Directors.
>
> " During the intervals between the meetings of the Finance Committee, and subject to its review, the chairman of the board and the chairman of the Finance Committee together, shall possess; and may exercise any of the powers of the committee, except as from time to time shall be otherwise provided by resolution of the Board of Directors.
>
> " Except as otherwise provided by the By-laws, or by resolution of the Board of Directors, all salaries and compensations paid or payable by the Company shall be fixed by the Finance Committee.
>
> " No director not an executive officer shall become a salaried employee of the Company except by special vote of the Finance Committee."

By the foregoing provisions the finance committee is given " all the powers of the Board of Directors in the management of all of the affairs of the Company " in the intervals between the meetings of the board of directors. Regular meetings of the board are held but once a month, thus throwing the actual management of the corporation almost entirely into the hands of the finance committee. Powers of revision and alteration are reserved to the board of directors but, as rights of third parties are not to be affected by the board's revision of the committee's acts, it is obvious that the committee's contracts cannot be interfered with.

The authority of the finance committee is again delegated to the chairman of the board and the chairman of the finance committee together, in the interim between committee meetings. This provision, though somewhat unusual, is almost essential because of the large membership of the committee. A committee composed of nine members is as large or larger than the ordinary board of directors, and some further centralization of power is obviously desirable. The two officials mentioned practically constitute an executive committee with full powers of action during the interim between committee meetings.

The by-laws of the United States Steel Corporation give very wide and unrestricted powers to the board of directors and to the finance committee, the usual powers of the stockholders being reduced to a minimum. This arrangement is almost essential to the successful conduct of the large corporations characteristic of modern industry and is due to the fact that their stockholders are too numerous and too widely scattered to permit of associated action.

Thus the stockholders of the United States Steel Corporation number near one hundred thousand and are found in every part of the world. It is obvious that any real action as a body by such a large and widely scattered membership is absolutely impossible. As a matter of fact, the proceedings and the functions of these stockholders are few. They are supposed to have given " value received " to the corporation for the stock they hold. They draw dividends with gratifying regularity. Once a year a handful of individuals, equipped with proxies, assemble in annual meeting to represent the army of stockholders really composing the corporation. These representative stockholders carry out a well arranged programme prepared for them by the managing bodies of the corporation, and go home. This is the limit of their active connection with the corporation, save when troublesome minority stockholders attempt to restrain the—to them—objectionable proceedings of the managing bodies by difficult and generally unsuccessful legal actions. The stockholders, in short, are merely the foundation which supports the corporate mechanism. Its operation is absolutely in the hands of the board of directors and the managing committee. The arrangement is effective but is not entirely representative.

§ 38. General Status of Finance Committee.

Under the powers usually assigned it, which are well set forth in the general provisions of the by-laws quoted in the present chapter, the finance committee is perhaps the most important of the managing bodies of the larger corporations. It is subordinate to the board of directors, but only when the board is in actual session. At all other times its authority in matters financial is practically supreme. It may take up, consider and act upon new matters, even though of vital importance to the corporation, without first referring them to the directors. Further, it may contract in such matters as lie within its scope and these contracts are binding upon the corporation and cannot be rescinded by the directors. In short, in the interim between board meetings, the finance committee is the board of directors as far as the corporate finances are concerned.

The necessity for care in the selection of the membership of the finance committee, and, on the part of the committee, for careful observance of all necessary rules of procedure, including particularly a full and accurate record of its proceedings, is obvious.

CHAPTER VI.

RELATION OF TREASURER TO OTHER CORPORATE AUTHORITIES.

§ 39. To the Stockholders.

The treasurer is the agent of the corporation but under the usual corporate arrangements his direct responsibility is to the board of directors, not to the stockholders. The stockholders might, in the absence of preventing statutes, reserve to themselves some measure of direct control over the treasurer. This is, however, seldom done, and in practice the treasurer usually has no official connection with the stockholders, save perhaps when an annual or an occasional special report is to be made, when dividends are to be paid, or amounts due from the stockholders to the corporation are to be collected. He is not under their supervision and owes them no direct duty. He must obey their instructions as expressed in the by-laws of the corporation but this is the limit of their usual authority. Should they attempt to compel his action by direct motion or resolution, they exceed their power and the treasurer is under no legal obligation to obey.

As stated in an early case, " The individual members of the corporation, whether they should all join, or each act separately, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent or servant to account, or discharge them from any liability."[1]

[1] Smith v. Hurd, 12 Metc. (Mass.) 371, 385 (1847).

§ 40. To the Board.

Speaking generally, the treasurer is directly responsible to the directors and must obey their instructions. Occasionally, however, the charter gives him certain specified powers and almost invariably the by-laws define his authority and prescribe his duties in detail. It is then beyond the power of the directors to disturb him in the exercise of the authority and the performance of the duties prescribed by these higher corporate authorities.

For instance, the charter may provide that the treasurer shall be, *ex officio,* a member of the finance committee. If so, the directors cannot deny him this right as long as the charter provision remains unchanged. Or the by-laws may, as is usual, assign the custody of the corporate funds to the treasurer. Should the directors, in defiance of this by-law provision, instruct the treasurer to surrender the corporate funds to the custody of some other officer of the company, they would, save perhaps in case of some special emergency, exceed their authority and the treasurer need not obey their instructions. On the contrary, should he obey them and should loss result to the company as a consequence, the treasurer might himself be held responsible.

The treasurer must, however, obey all such proper instructions of the directors as are not in conflict with charter or by-law provisions, or are intended to supplement and make them effective. In all such matters the directors are entirely within the scope of their powers and their instructions are as binding upon the treasurer as are the by-laws themselves.[2]

Sometimes also the directors are given express authority to modify, repeal or amend the by-laws and their power over the official acts of the treasurer is then practically complete. When this is the case, statutory and charter provisions alone are superior to their authority.

It may be added, however, that the powers discussed are

[2] See §§ 7, 25.

the powers of the board of directors and not of the individual directors composing the board. These individual directors have certain powers of their own. Thus, without special authorization thereto, any member of the board of directors may inspect the corporate books at any reasonable time—save for purposes hostile to the corporation[3]—and may examine at his discretion into the acts of the treasurer or of any other corporate official. Also as an individual director, he may make such suggestions to the corporate officials as he sees fit and such suggestions will naturally have weight.

The individual director has not, however, any power to enforce compliance with his suggestions, nor has he the right to change, censure, suspend, remove or even direct an officer of the corporation, such rights and powers inhering only in the board collectively. A director may be specially authorized by the board to do any of these things and will then have all necessary power for its performance, but he has no such authority by mere virtue of his board membership.[4]

The treasurer reports to the directors and, as already stated, is governed by their instructions in all matters not specifically covered by charter or by-law provisions. The relations between the treasurer and the board of directors are therefore very close and are usually harmonious. Both are supposed to have the financial welfare of the corporation at heart and to be working together to advance it and it is but rarely that the exact measure of the board's authority over the treasurer, or of the treasurer's independence of the board, comes into question.

§ 41. To the Finance Committee.

Nominally the finance committee is subject to the board of directors. It is, however, always composed of members of

[3] Heminway v. Heminway, 58 Conn. 443 (1890).
[4] People v. Throop, 12 Wend. (N. Y.) 181, 183 (1834).

the board and generally of its best financiers, and the directors are usually and wisely quite content to leave the financial management of the corporation entirely in its hands. The finance committee is then practically the board of directors so far as the finances of the corporation are concerned. The committee will naturally report to the directors at frequent intervals, but its reports, acts and recommendations are usually sure of approval in advance. In practice, a finance committee possessing the confidence of the board will direct the financial affairs of the corporation from year's end to year's end without interference. The allegiance, co-operation and obedience the treasurer ordinarily owes to the directors is then transferred to this committee.

If the treasurer is a member of the board of directors, he is usually also a member, *ex officio,* of the finance committee and participates in its proceedings. If, however, he is not a director, he cannot be made an active member of the committee. This is, as already stated, because the committee exercises discretionary powers belonging to the board, which cannot be legally conferred upon a committee composed in whole or in part of members who are not directors.[5]

If the treasurer is a member of the finance committee, and particularly if he is of some financial ability and standing himself, the direct and entire charge of the financial affairs of the corporation is apt to be left in his hands, the remainder of the committee acting merely in an advisory capacity. Even where the treasurer is not a member of the committee, the financial matters of the corporation are still as a rule left largely to his care. In such case he reports frequently and informally to the committee, either receiving authority for the particular act or policy under discussion, or approval of his actions in matters which have already been consummated.

When the treasurer has not sufficient experience and ability to conduct the general financial affairs of the company

[5] See § 34.

to this extent, he works in close accord with the members of the finance committee, carrying out their instructions, consulting with them frequently, and at all times referring to them matters of importance, or such as may be beyond his immediate authority, ability or control.

Since the finance committee practically takes the place of the board of directors as far as the corporate finances are concerned, it usually and naturally has all the authority of the board itself over the treasurer. The matter is, however, one that may be determined absolutely by the charter or by-laws. These usually and properly prescribe that the treasurer shall report to and be controlled by the finance committee.

The general relation between the finance committee and the treasurer should be that of harmonious and effective cooperation. Both are working to the same end, i. e., the best possible administration of the financial affairs of the corporation, and there should be no conflict or friction between them.

§ 42. To the Auditor.

In the smaller corporations the auditor is merely an occasional officer called in for the purpose of investigating and passing upon the treasurer's accounts. In such case his relation to the treasurer is temporary and needs no special discussion. The treasurer's books are opened to the auditor, who examines them, checks up their statements and reports his finding to the board. The treasurer will, naturally, furnish any proper information and assistance required by the auditor in the course of this examination and will facilitate his work in every way.

In the larger corporations, however, the conditions are materially different. Here the auditor, or comptroller as he is sometimes designated, is one of the regular officials of the corporation and his duties and the relations existing between him and the treasurer depend entirely upon the respective duties of the two officials. These are usually set forth in the by-laws and vary in different corporations.

In the larger corporations the auditor is the accounting officer, taking entire charge of the general bookkeeping. The actual receipt, custody and disbursement of the funds and their general management remain with the treasurer. Detailed records of these receipts and disbursements as well as the general accounts of the corporation are kept in the auditor's department, the treasurer's records also covering these items but in a less detailed way.

In some corporations, accounts to be paid are authorized by the auditor, are approved perhaps by some other officer, and the actual payment is made by the treasurer. In other cases the payments are for all practical purposes made by the auditor, vouchers, duly signed and countersigned, being sent out to the parties to whom payments are due, these vouchers being payable on presentation to some designated bank which acts for the treasurer. Or again the voucher will be prepared or passed upon by the auditor and perhaps by the official in whose department the obligation arises, and this voucher when signed by the treasurer becomes a check, honored upon presentation at a designated bank.

The whole matter is one of adjustment, varying, as stated, in different corporations. In any case the auditor and the treasurer usually have distinct departments and while their accounts overlap in some measure as to cash received and disbursed, there is but little room for conflict between them. Each is independent of the other and exercises functions that should be distinct and so clearly defined that clashing is impossible.

§ 43. To the Other Officials.

The three essential executive officers of the corporation are the president, the secretary and the treasurer. In the usual corporate organization the president is the superior officer of the three, and is usually given certain powers of supervision over the other two.

The secretary and treasurer are entirely independent of each other. Also their respective functions are so distinct that friction between them is unusual and absolutely unnecessary. In the smaller corporations the two offices are frequently and advantageously united in the same person.

Between the president and the treasurer the probability of friction is much greater. The president, as already stated, is usually given certain general powers of supervision over the other corporate officers, and as these powers are rarely defined with clearness, there is at times room for real difference of opinion as to their limits.

Under the usual by-law provisions the president has the right to inspect and examine the books, accounts and records of the treasurer at any reasonable time.[6] He has, however, no right to interfere directly with the treasurer's actions unless he sees some actual neglect or improper performance of duty. In any such case it is his duty to call the matter to the treasurer's attention. If the latter is obviously at fault, it is his duty to heed the president's instructions. If, however, there is a difference of opinion between the two officials as to whether or no the treasurer is at fault, the president, unless specially empowered, cannot enforce his views directly. All he can do is to report the matter to the directors, and both officers will then be governed by the directors' decision.

As the president is the chief executive officer of the corporation, the treasurer is naturally expected to confer with him on matters of unusual importance or difficulty and to be guided to a greater or less extent by his opinions and suggestions. The president, however, as stated, cannot himself force the treasurer to heed his instructions unless he has been given some special power in the matter by charter or by-law provisions, or by action of the board of directors.

[6] People, etc. v. Goldstein, 37 App. Div. (N. Y.) 550 (1899).

The offices of president and treasurer are occasionally united in one person but not commonly, as the respective duties of the two positions are apt to conflict. Thus in some states the statutes require the signature of both the president and treasurer to certificates of stock and the by-laws commonly prescribe a similar signature for the corporate checks and other instruments. It is obvious that the whole purpose of these precautionary measures would be defeated if the two offices were combined.

CHAPTER VII.

THE TREASURER'S LIABILITIES.

§ 44. Duties and Liabilities of Treasurer.

The treasurer is the custodian of the corporate funds.[1] In the smaller corporations he is also usually required to keep or to be responsible for the keeping of the corporate books of account. In the larger corporations he is held responsible only for the records of his own department. In all corporations he is expected to make various financial reports as they are needed, and he must perform such other duties as may be required by the by-laws or be properly demanded of him by the directors. When his term of office expires, or before if legally demanded, he must return to the corporation all its moneys and property, including the books of account.

The treasurer's duty in regard to the moneys and the property of the corporation entrusted to his care, is that of an agent, and he is held to the same measure of accountability. In an early New York case it was expressed as follows: "The duty of a treasurer is to keep the moneys of his principal distinct from his own, and to be ready at all times to pay over what balance he owes to his principal." With sage recognition of the fact that readiness to perform is not performance, the learned judge continues, "and to pay the balance on demand."[2]

In his duties outside those relating directly to the custody of the corporate funds and property, the treasurer is likewise

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[1] Providence, etc. Co. v. Dixon, 114 N. Y. 80 (1889); Laurel Springs Land Co. v. Fougeray, 57 N. J. Eq. 318 (1898).

[2] Second Ave. R. R. Co. v. Coleman, 24 Barb. 300 (1857); Hunter v. Robbins, 117 Fed. Rep. 920 (1902).

acting as an agent and employee of the corporation and is liable to it if he fails in the proper performance of these duties as is any other agent or employee.

§ 45. To Whom Liable.

When liability is incurred by the treasurer in connection with the duties of his office, it is usually to the corporation, though it may be to the individual stockholders of the corporation, or even to individuals outside the corporation. Beyond this there is in some states a civil liability for the non-performance of certain duties prescribed by statute, and in all states there is a criminal liability for acts in violation of the penal statutes.

Thus, if the treasurer loses a portion of the company funds through careless handling, he is responsible to the corporation. If he makes an official report to the stockholders which is false in some material respect and the stockholders act upon this false information and lose money thereby, the treasurer is personally liable to the individual stockholders by whom these losses are incurred. Or if he misrepresents the financial status and ability of the corporation to an outsider in order to induce him to give credit to the company, he is liable to such outsider for any losses incurred as a result of his false representations. In many states if he fails to make certain specified reports, he is liable to fine. In all states, if he embezzles the corporate funds or uses his official position to defraud, he is subject to a criminal prosecution.

§ 46. Sources of Liability.

Speaking generally, the treasurer may be liable for failure to perform, or for the improper performance of the duties of his office, as follows:—

(a) Neglect of or non-performance of duties.
(b) Faulty performance of duties.

(c) Unauthorized acts.
(d) Illegal acts.

§ 47. (a) Neglect of or Non-Performance of Duties.

As a rule, the treasurer is liable for any loss or damage incurred through his neglect of or failure to perform his duties. Thus, if he fails to deposit the corporate funds in due time, or in accordance with the requirements of the by-laws or the directors, and because of this neglect they are burned, stolen or otherwise lost, the treasurer is responsible to the corporation. Or if money is due and the treasurer does not take the necessary steps for its collection, and as a result it is lost to the corporation, he is again responsible. Or if he refuses to perform his proper duties and the corporation is involved in losses thereby, he is responsible to the corporation for the amount so lost. In this connection it may be said that the proper duties of the treasurer are those assigned him by the charter and by-laws of the corporation and any other reasonable duties not in conflict with these, assigned him by the board of directors.

In any case of loss to the corporation because of neglect of duty on the part of the treasurer, the measure of his liability is usually the amount actually lost, or the damage actually sustained in consequence of such failure or non-performance. He cannot ordinarily be held liable for losses indirectly due to his failure. For instance, if the corporate funds in his hands are not deposited as required by the by-laws or the instructions of the directors, and are stolen while so improperly held by the treasurer, he is liable only for the actual amount so lost. It is obvious that this loss might involve damages to the corporation far greater than the amount actually stolen. It might perhaps prevent important payments and thereby cause the forfeiture of valuable property, or injure the general credit of the company, or cause the corporation to fail on important contracts, involving losses tenfold greater than the actual theft, but for these indirect losses the treasurer cannot ordinarily be held.

It is to be noted that the liability of the treasurer for neglect or non-performance of his duty is to the corporation and not to the individual stockholders. Any action, therefore, against the treasurer for losses incurred by reason of his neglect or failure must be instituted by the board of directors, and not by the stockholders, either as a body or individually. They suffer with some directness, as the value of their interests in the corporation is depreciated or diminished by the treasurer's misdoings, but the right of action is in the corporation and not in the stockholders, save perhaps in extreme cases when the treasurer's neglect is very flagrant and the directors refuse to act.[3]

In the larger corporations and wherever the value of the corporate funds and property in the treasurer's hands is material, it is usual to require him to give bond for the faithful performance of his duties. This bond, if good and of sufficient amount, will usually cover any losses occasioned by the failure or the misdeeds of the treasurer and be an efficient protection to the corporation.[4]

§ 48. (b) Faulty Performance of Duties.

The treasurer may render himself liable for faulty performance of his duties as well as by neglect of these duties, and in such case his liability may be to outside parties or to the corporation. For instance, if the treasurer signs a note of the corporation and instead of using the proper corporate signature, signs his own name followed by the term "Treasurer," he will in some states and under some circumstances make himself liable as a principal, although he had no intention of so doing and was not expected to be personally involved.[5]

[3] Brinckerhoff v. Bostwick, 88 N. Y. 52 (1882); Brewer v. Boston Theatre, 104 Mass. 378 (1870); Knoop v. Bohmrich, 49 N. J. Eq. 82, 83 (1891).

[4] See Chap. VIII, "The Treasurer's Bond."

[5] Merchants Nat. Bank v. Clark et al, 139 N. Y. 314 (1893); First Nat. Bk. v. Wallis, 150 N. Y. 455 (1896); Cook on Corps., § 724; Reeve v. First Nat. Bank, 54 N. J. L. 208 (1891).

So also, if the treasurer in paying some corporate indebtedness, carelessly draws a check for a larger amount than is required, and the excess cannot be recovered from the payee, the treasurer is liable to the corporation for its amount.

The liability of the treasurer from faulty performance of duty seldom arises. His position is one of trust and responsibility and the incumbent is usually experienced in business matters and accustomed to the handling of funds. Under these circumstances it is hardly to be expected that he will err so grossly in any of his official acts as to subject himself to liability.

§ 49. (c) Unauthorized Acts.

The treasurer is the agent of the corporation and within the scope of his authority can act for and bind it. If, however, he acts beyond the scope of his usual duties, not being authorized thereto, his act is without validity and the corporation is not necessarily bound. Also in any case of loss resulting from his unauthorized acts he is liable in damages to the party suffering such loss, whether it be the corporation or an individual. This is the usual liability of an agent exceeding his authority.[6]

For instance, if the treasurer of a corporation, not being authorized thereto, orders a costly piece of machinery for the use of his company, the corporation may lawfully refuse to receive it, even though the order was accepted by the manufacturer on the supposition that the treasurer had been duly empowered to make the purchase. In such case the maker of the machinery is the injured party and may hold the treasurer personally responsible for any real loss involved in the transaction.

Or should the treasurer, not being authorized thereto, enter into a contract on behalf of the corporation to supply

[6] Kroeger v. Pitcairn, 101 Pa. St. 311 (1882); Baltzen et al v. Nicholay, 53 N. Y. 467 (1873); Taylor v. Nostrand, 134 N. Y. 108 (1892).

certain goods at a low price, the corporation is not bound by his agreement unless it ratifies his act,[7] and if it does not, the treasurer is liable to the other contracting party for any direct loss involved.

If, however, the treasurer, though unauthorized thereto, performs some act within the apparent scope of his powers and the party with whom he deals is unaware of the treasurer's lack of authority, the corporation is bound by the act but if any loss results, the treasurer is liable to the corporation. For instance, if the treasurer, having neither express nor implied authority therefor or perhaps acting contrary to the instructions of the board, enters into a contract with a banking house to discount a large amount of the corporation paper at such an unfavorable time or under such conditions as to involve a loss, and the banking house supposed the treasurer to have authority to make such contract, the corporation cannot repudiate the treasurer's action as unauthorized.[8] On the contrary, it must abide by the terms of the agreement and its only recourse is against the treasurer and the measure of its damages is the loss actually involved.

The treasurer's general liability for unauthorized actions is well expressed in the following quotations: "It is the first duty of an agent, whose authority is limited, to adhere faithfully to his instructions in all cases to which they can be properly applied. If he exceeds or violates or neglects them, he is responsible for all losses which are the natural consequences of his act."[9] "The cases in which agents have been adjudged liable personally, have sometimes been classified as follows, viz.: 1st. where the agent makes a false representation of his authority with intent to deceive; 2nd. where with knowledge of his want of authority but without intending any fraud, he

[7] See § 21.

[8] Austrian & Co. v. Springer, 94 Mich. 343 (1892); Inglish v. Ayer, 79 Mich. 516 (1890); Home Life Ins. Co. v. Pierce, 75 Ill. 426 (1874); Brown v. Franklin Mut. Fire Ins. Co., 165 Mass. 565 (1896).

[9] Whitney v. Merchants' Express Co., 104 Mass. 153 (1870); see also Wilts v. Morrell, 66 Barb. (N. Y.) 511 (1873); Taylor v. Nostrand, 134 N. Y. 108 (1892).

assumes to act as though he were fully authorized; and, 3d where he undertakes to act, bona fide believing he has authority, but in fact has none, as in the case of an agent acting under a forged power of attorney. As to cases fairly brought within either of the first two classes there cannot be any doubt as to the liability of the self-constituted agent, and his liability may be enforced either by an action on the case for deceit, or by electing to treat him as principal. While the liability of agents, in cases belonging to the third class, has sometimes been doubted, the weight of authority appears to be that they are also liable."[10]

§ 50. (d) Illegal Acts.

The illegal acts of which the treasurer is most commonly guilty may be divided into two classes: (1) Fraudulent acts, such as false or misleading statements or reports as to the property or financial condition of the corporation made or certified to by him; (2) criminal acts, such as embezzlement of the funds entrusted to his charge.

Offenses of the first class are not infrequent and may be offenses against individuals, or against the state. In case of misrepresentation to individuals, the treasurer is liable to the parties misled as is any agent[11] and may subject himself to a criminal liability as well. In case of false representations to the state, he is subject to special penalties provided by the statutes.

False or fraudulent reports are prohibited by the laws of almost every state in the Union. Varying punishments are imposed. Usually the statutes provide that a treasurer making or concurring in any representation materially false in any of its details, shall be liable to any individual damaged thereby to the amount of his loss. Frequently a further and more serious penalty is imposed, consisting of both fine and imprisonment.

[10] Kroeger v. Pitcairn, 101 Pa. St. 311, 317 (1882).

[11] Morgan v. Skiddy, 62 N. Y. 319, 326 (1875); Kroeger v. Pitcairn, 101 Pa. St. 311, 317 (1882).

The criminal acts of the treasurer may be of two classes: (1) Those inuring to his direct personal benefit, such as embezzlement of the corporate funds or obtaining money under false pretenses from the corporation, or from those with whom the corporation is transacting business; (2) participation in acts of the corporation that would in an individual be criminal.

The liability of the treasurer for criminal acts inuring to his personal benefit are the same as for any other individual. Such offenses are neither better nor worse, nor does their punishment differ when committed by a corporation official.

If criminal acts are committed by the corporation, the treasurer or any other officer responsible therefor, or knowingly assisting or concurring therein, is liable to prosecution and punishment.[12] In such case it must be shown, however, that "the corporation did them by his hand, act, direction or permission, which of course is direct proof of his own acts, or such circumstances must be shown as to justify the conclusion, as a fact, that what the corporation did, he did."[13] In other words, he is an agent with an agent's usual liability but no more.

Thus if the corporation obtains credit or moneys by means of false representations, i. e., under false pretenses, in order to hold the treasurer responsible, either civilly or criminally, it must be shown that he participated in such act or knowingly allowed it to be done.[14] As a corporation cannot be held criminally liable, and as it is far more difficult to secure the criminal conviction of its officials than to enforce a civil liability, criminal prosecutions against the treasurer in cases of the kind are exceedingly rare. Civil prosecutions are not so uncommon and if his participation and responsibility can be proved, he is held.

Outside of false representations, acts involving criminal

[12] Weber v. Weber, 47 Mich. 569 (1882); Hubbard v. Weare, 79 Iowa 678 (1890); Vreeland v. N. J. Stone Co., 29 N. J. Eq. 188 (1878).

[13] People v. England, 27 Hun 139 (1882).

[14] Wakeman v. Dalley, 51 N. Y. 27 (1872); Arthur v. Griswold, 55 N. Y. 400 (1874); Morgan v. Skiddy, 62 N. Y. 319 (1875).

liability are not often committed under corporate direction. Sometimes, however, they do occur as where the agents of a corporation resort to violence or the destruction of property in order to hinder or prevent the success of a rival concern. In any such case the corporation itself can naturally only be held in damages, but the agents, by whom the criminal act is performed, are liable to punishment as if the act were their own deed, instigated and committed by them alone.

§ 51. Statutory Liabilities.

In many of the states the liabilities discussed in the present chapter, which in the main are common law liabilities, have been further enacted into statutory liabilities. Also in some cases specific additional penalties have been added. An instance of this has already been given in the case of false reports, where the treasurer is not only liable to the individuals injured by such false reports, but is subject to a prescribed statutory penalty as well, this penalty usually including both fine and imprisonment.

In addition to the common law liabilities, there are in some states penalties for refusal to allow the proper inspection of books; for failure to make certain reports; for permitting stockholders to withdraw any part of their investment in the corporation and for allowing other impairments of the capital stock. Most of the things thus penalized are in themselves morally indefensible.

It will be found, however, that occasionally acts or omissions entirely innocent in themselves have, by direct statutory provision, been made punishable offenses. Thus in some states the omission to file certain prescribed reports at a particular time is punished by fine. Statutory provisions of this kind are, however, not numerous and, as far as applicable to the treasurer of the corporation, are restricted almost entirely to the corporate reports.

CHAPTER VIII.

THE TREASURER'S BOND.

§ 52. General.

The corporate funds are usually placed in the treasurer's care with but little reservation, and, in the absence of special protective provisions, the measure of their safety is the integrity and efficiency of the treasurer. If he is dishonest, they are liable to defalcation; if he is careless, they are liable to loss.

The safeguards that can be thrown round the corporate funds while in the treasurer's custody are but few. Usually he is required to deposit them as soon as they come into his hands, and their withdrawal may be effected only by check signed and countersigned as required by charter, by-laws or directors' resolution. Notes and drafts likewise usually require signature and countersignature. Regulations as to corporate loans, discounts and other financial transactions restrict his power. Audits of the treasurer's books are held from time to time. His character, standing and financial responsibility always have much weight.

It is obvious, however, that all this affords but very partial protection to the corporate funds, and still less to the other property entrusted to the treasurer's care. One further protective measure of importance exists, and this is the treasurer's bond, the most effective and most relied upon of all the material safeguards possible.

The treasurer's bond is an instrument whereby the parties signing it bind themselves within the limits of the bond to make good any losses the corporation may suffer from the dishonest acts or wilful omissions of the treasurer. The obligations of the bond are governed strictly by its terms, but the usual personal bond requires (1) the faithful performance of the treasurer's duties, (2) the safety of the corporate funds and other property entrusted to his care, and (3) their due return on the expiration of his term of office, or at any prior time upon legal demand.

§ 53. Statutory Requirements.

In many states, as Indiana, Maine, New Jersey, etc., the state statutes merely require that the treasurer be bonded, without requirement as to the amount or conditions of the bond. Under these circumstances a reasonable bond is understood, but the exact amount, its sureties and other details must either be prescribed in the by-laws or be fixed by the directors.

In other states, as, for instance, Pennsylvania and Nevada, the statutes provide that the treasurer shall be bonded, but expressly state that this bonding shall be as required by the by-laws. The difference is slight. In the states first mentioned, the law-making powers are indifferent as to whether the details of the treasurer's bond are prescribed in the by-laws or by the board of directors. In the last-named states, it is intended that the by-laws shall prescribe them, and no obligation as to their details is imposed upon the directors.

If, then, in the first case the by-laws were silent on this subject and the directors did not require the treasurer to give a suitable bond, they might be held liable for any resulting loss. In the second case, if the by-laws were again silent and the directors did not require the treasurer to give a bond, they could not be held responsible.

In other states, as in New York, Colorado, Delaware, Massachusetts, etc., the statutes merely provide that security may be demanded of the treasurer. As to the stockholders, this is merely a restatement of a power already existing. They may, if they wish, provide in the by-laws that a bond shall be required of the treasurer but they might do this with equal force if the statutes were silent. As to the directors, however, such statutes are of greater weight, giving them, in the silence of the by-laws, the unquestioned right to require a bond from the treasurer,—a power which otherwise is doubtful. The statutes of the states mentioned are not, however, mandatory, and if the directors see fit, they may omit the requirement and cannot be held liable in case of resulting loss to the corporation.

§ 54. Corporate Requirements.

In many states the statutes make no reference whatsoever to the bonding of the treasurer. Regardless of this fact, the stockholders have full power to require him to give a bond. Such a requirement might be and sometimes is incorporated in the charter, but is usually found in the by-laws.

When the by-laws require a bond, they will sometimes specify its amount and the number of sureties, or perhaps provide instead that the bond of a reputable surety company shall be given. Usually, however, they merely direct that a bond shall be required of such amount and with such sureties as the board of directors may prescribe. Frequently they are merely permissive, stating that the board may require the treasurer to give a bond, all details being left to the board.

In all cases where the by-laws require a bond of the treasurer, the directors have full power to prescribe any details not covered by the by-law provision. Should neither the statutes nor the charter or by-laws of the corporation require such bond, it is doubtful whether the board would of its own authority have power to compel it.

§ 55. Nature of the Bond.

The treasurer's bond is a formal undertaking of certain parties who are specified therein and by whom the bond is signed, that in the event of loss arising from the defalcation or other dishonesty of the treasurer, they will make good such loss up to the amount of their bond. When such a bond is given, it is usually signed by the treasurer and by his bondsmen as well, and in all cases the details of the liability involved are set forth in full in the instrument.

Formerly personal bonds were the rule and the bondsmen were usually friends of the bonded official. Of recent years, however, responsible surety companies supply bonds of the kind, and the personal or individual bond has been largely superseded.[1]

The personal bond is generally sweeping in its nature, covering any loss occasioned by defalcation or dishonesty on the part of the treasurer and also providing for the proper restoration to the company, when legally demanded, or at the expiration of the treasurer's term of office, of all moneys, papers, vouchers, documents, books of account and other property belonging to the company then in his hands.

The wording of the bond will, however, affect and directly limit the extent of the sureties' liability. Usually bondsmen are not held liable for accidents or mistakes of the principal, or for his inability to perform all the duties of his official position.[2] But where the condition of the bond provides that the principal shall perform all the duties of his office and that the sureties shall pay all damages or losses arising from any failure to perform such duties, the bondsmen may be held.[3]

§ 56. Amount of Bond.

There is no rule as to the amount of the treasurer's bond. Manifestly the matter is one that must be governed by the conditions of each special case. Its amount is supposed to be

[1] See § 58.

[2] Morris, etc. Co. v. Administratrix, 21 N. J. L. 100 (1847); Union Bank v. Clossey, 10 Johns (N. Y.) 271 (1813); contra, Am. Bank v. Adams, 12 Pick. (Mass.) 303 (1831).

[3] Union Bank v. Thompson, 8 Rob. (La.) 227 (1844).

proportionate to the risk involved, but frequently it will be fixed haphazard, or at some arbitrary amount deemed sufficient, or perhaps the cost of the bond will determine its amount. In all cases the bond should be adequate to cover any loss reasonably possible.

The treasurer of a corporation is usually a man of standing and character and this will in itself have a direct bearing in fixing the amount of his bond. Also he is frequently of some financial responsibility and this will have weight, as the extent of the treasurer's liability is not limited by the amount of his bond. The bond is merely a crystalization of a portion of his liability in convenient shape for ready realization in case of loss for which he is responsible, and any property he may own is available beyond this in case the bond is insufficient.

Also some measure of safety is ensured by the usual checks existing or placed upon the treasurer's official actions, i. e., the general knowledge of the business and of the treasurer's accounts and affairs possessed by the directors and other corporation officials, the accounts required to be kept, the periodical audits, the prompt deposit of funds, the countersignatures to checks, notes, drafts, etc., etc.

All this must be taken into consideration as must also the general improbability that in event of the treasurer's neglect or dishonesty, all the corporate funds and property in his possession will be lost. The bond is therefore but a small proportion of the amount entrusted to the treasurer's care when this is at all considerable, and the ratio diminishes rapidly as the amount involved increases. For instance, the treasurer of some small corporation with a cash balance never exceeding a few thousand dollars, will frequently be required to give a bond for a thousand dollars or more. In this case the bond ranges from twenty-five to even one hundred per cent. of the total risk. On the other hand, a receiver recently appointed for the Knickerbocker Trust Company with property values in his care of between fifty and sixty million dollars, was required to give a bond of but $500,000,—a large bond, it is true, but less than one per cent. of the total amount involved.

The reason for this difference is obvious. The smaller amount is much more fully and unreservedly in the treasurer's custody and if he is dishonest or careless, might easily disappear in its entirety. On the other hand, the larger amounts are surrounded with materially different conditions,—the actual funds are not so directly in the custodian's care; greater publicity in their handling is inevitable; incidental safeguards increase; loss through ordinary carelessness is almost impossible, and defalcations, should they occur, could not ordinarily run to any large amount before discovery.

Frequently, as stated, the cost of bonding has some weight in determining its amount. Under the personal bond this element does not enter in, but with the surety company bond the cost increases with the size of the bond and its amount will naturally be kept as low as wise prudence will permit. Sometimes with penny-wise economy, its amount is fixed still lower.

§ 57. Personal Bonds.

As already stated, the bond formerly given by the treasurer was almost invariably signed by individuals. These individuals were usually friends of the treasurer who went on the bond merely as an accommodation to him and without expectation of compensation and equally without expectation of ever being called upon to meet its obligations. If, then, through the treasurer's fault or misfortune, losses occurred and these friends were called upon to make good the undertakings of the bond, they naturally felt the demand to be a hardship, as in truth it was. They were legally liable, but they did not feel the moral obligation of a just debt, and would therefore delay payment as long as possible and frequently evade it altogether, or, perhaps, be found unable to pay. The whole system was, and is, unsatisfactory and ineffective.

The personal bond is still used to a considerable extent, and when it is employed the standing of the treasurer's sureties or bondsmen becomes a matter of the first importance. It is obvious that the value of the bond rests not alone in the financial ability of the bondsmen but to a considerable extent upon their moral responsibility as well, and both their financial standing and general character should therefore, when the bond is large, be subjected to a searching scrutiny. This is a matter entirely within the province of the directors. Usually the bondsmen of a corporation treasurer are personally known to the directors, and the desirability of these bondsmen may then be decided from knowledge so gained without the necessity of special investigation.

It need hardly be said that the actual drafting of the instrument by which the treasurer's bondsmen are held should be careful and competent. A defective instrument might easily result in a total loss of the protection the bond was expressly intended to afford.[4]

§ 58. Surety Company Bonds.

The surety company bond is similar in its general nature to a personal bond, its carefully restricted liability and the fact that it is signed by a surety company instead of by individuals constituting the only material difference. The surety companies supplying these bonds are usually well-known and substantial, and the conditions surrounding the issue of their bonds are such as to make the security afforded far superior within its limits to that of the ordinary personal bond.

When a surety company bond is desired, the treasurer makes his application in prescribed form, specifying the amount required. The company then investigates the character and standing of the treasurer to decide whether he is a suitable person for the position and one who may be safely bonded. If he is accepted, a fee is paid the company according to the amount of the bond and the nature of the risk, and the bond is issued.

[4] See "Forms," Chap. XXXVI.

The treasurer's application to a surety company is formal. It usually involves a very complete statement of his past history and present condition, covering his social and business habits, standing and connections, and giving all such details of his earlier and present life as will enable the surety company to judge of his fitness as a custodian of money and property. The applicant is also required to give a number of suitable references, i. e., people who, while not relatives, have been in a position to judge of the character and responsibility of the applicant. These references are communicated with and a written statement as to the important features of the treasurer's character, reputation and past history are, if possible, obtained from each. The investigation is usually thorough and searching. If the applicant passes the ordeal successfully, the company issues its bond in accordance with his application.

In the case of a corporation treasurer, the surety company's fee for a bond of moderate amount—say a few thousand dollars—is from four to seven dollars per annum for each thousand dollars of bonded obligation assumed by the company. These fees are sometimes paid by the treasurer himself and sometimes by the corporation. It would seem proper that the corporation should assume this expense, though no established rule prevails.

Bonding by a surety company is, as has been said, a strictly business transaction. Before taking the risk the company makes a careful investigation and takes every proper precaution. Its fees are based on careful calculation and long experience and are an adequate payment for the risk assumed. A certain percentage of loss is anticipated. Then, when loss does occur for which the company is liable under its bond, there is seldom, if ever, any attempt on the part of a reputable and responsible surety company to either evade or delay payment of its obligation.

Further it may be said that the reputation and financial standing of the surety companies engaged in the business of bonding may be easily and satisfactorily established; that there is usually neither trouble nor delay in payment when unquestioned obligations arise; that in case of doubt, necessitating legal proceedings in order to determine whether or no the bondsmen are liable, the courts construe the bonds given by surety companies much more strictly than in the case of bonds given by individuals, and, finally, that in spite of its limited protection and many conditions, the surety company bond has almost superseded the personal bond. (See Form 32.)

§ 59. Liability of Bondsmen.

If the treasurer is not a party to the bond, i. e. does not sign it, he is himself primarily responsible in case of loss covered by the bond and must first be proceeded against. If the loss cannot be recovered from him, recourse may then be had on his bondsmen.

If, however, the treasurer, as is usually the case, has joined his bondsmen in signing the bond, he is liable on the bond just as they are, and proceedings may be begun against him or against his bondsmen at the discretion of the corporate officials, in accordance with the wording of the bond.

If the bond is phrased "jointly and severally," the bondsmen signing the instrument are each individually liable to the full amount of the bond and action in case of loss may, if desired, be commenced against the treasurer alone or against any one of his bondsmen, or against any or all of the parties at the same time.[5] In Massachusetts suit in such case must either be brought against one or against all the obligors.[6] As among themselves, however, each one of the bondsmen is responsible for his individual proportion of any loss incurred and if payment is enforced from one bondsman, he is legally entitled to collect the pro rata amount due from each of his fellow bondsmen.

[5] Poullain v. Brown, 80 Ga. 27 (1887); McKee v. Griffin, 60 Ala. 427 (1877).

[6] Leonard v. Speidel, 104 Mass. 356 (1870).

If the bond is phrased "severally" as opposed to "jointly and severally," then each bondsman is liable only for his proportionate amount of the bond, or of any less amount becoming due thereunder, and in case of loss, proceedings must be brought against each one of the bondsmen for his individual liability.[7]

Usually liability of a personal bond is limited to the amount actually and directly lost by the neglect or dishonesty of the treasurer. In case the amount of such loss is less than the amount of the bond, the bondsmen are only liable for the loss actually incurred but are still held on the bond for any future losses and this liability continues until the bond expires or until they have paid out the full amount of their obligation thereunder. If the loss is greater than the amount of the bond, the bondsmen are liable up to its full amount but not beyond, and upon payment of its amount the bond is extinguished and of no further effect. In other words, the amount specified in the bond marks the limit of the bondsmen's liability.

When a bond is once executed the bondsmen cannot withdraw or escape from its liability until the legal termination or prior cancellation of the bond. They may have reason to suspect the treasurer of dishonesty or carelessness, or for other reasons may greatly desire to end their liability, but this they cannot do unless with the consent of the corporation. They may neither cancel their obligation nor escape it.[8] They can only wait until time works their relief or perhaps their ruin. A cancellation clause is sometimes inserted in personal bonds, and always in surety company bonds, for the express purpose of its termination, if desired, before the end of the bonded period.

The undertaking of a bond is an onerous one that should not be entered upon by individuals as lightly as is usually done.

[7] State v. Powers, 52 Miss. 198 (1876); Brandt on Suretyship, § 194.

[8] Stearns on Suretyship, § 119.

The expectation is, of course, that no loss will occur and no active obligation fall upon the bondsmen. Instances showing the fallacy of this expectation are, however, numerous, and when liability does arise, the results are apt to be serious—too serious to justify the signing of a bond as a mere matter of friendship, when a few dollars will, as a matter of ordinary business, obtain a perhaps better bond frôm a responsible surety company.

In case of doubt, or when legal proceedings are necessary to enforce the liability of bondsmen, the courts, as already stated, construe the bonds given by surety companies much more strictly than the bonds of individuals. The leniency shown the individual in this case arises from the fact that he generally takes no part in the writing of the instrument and does not profit from the transaction. He is in fact merely an accommodation party and is therefore entitled in case of doubt, to the strictest construction in his favor.[9]

In the case of a surety company, the reverse of all this is true. The company itself prepares the form of bond, carefully investigates and limits the risk it assumes, protects itself in every particular, and is paid adequately for its undertaking. Hence, when the courts pass upon such a contract, their construction in case of doubt is against the surety and in favor of the party seeking indemnity.[10]

§ 60. Termination of Bond.

Unless the treasurer's bond contains some clause providing that its liability shall continue, or sooner terminate; it is limited to the term of office for which the treasurer was elected. If the treasurer is re-elected, his bond, unless specifically so provided in the instrument, does not pass over to the new term but must be renewed.[11] Also if the election of officers fails

[9] Stearns on Suretyship, § 255; Ulster Co. Sav. Inst. v. Ostrander, 15 App. Div. 173 (1897); Ward v. Stahl, 81 N. Y. 406 (1880).

[10] Am. Surety Co. v. Pauly, 170 U. S. 133 (1897); Tarboro v. Fidelity Co., 128 N. C. 366 (1901).

[11] Citizens' Loan Assn. v. Nugent, 40 N. J. L. 215 (1878); Savings Bank v. Hunt, 72 Mo. 597 (1880).

and the treasurer holds over beyond the elected term, his bondsmen are not responsible for this hold-over term unless this continuing responsibility is clearly expressed in the bond.[12]

The death of the treasurer terminates his bond, as does likewise his peremptory or accepted resignation, provided in either case that all the corporate funds and other corporate property entrusted to him are returned. Also if there is any material change in the duties and responsibilities of the treasurer, the old bond may be terminated or vitiated by the changed conditions and a new bond should then be required.[13]

It is to be noted that while the liabilities of a bondsman are limited to losses occurring during the term for which the bond is given, the bondsmen are not released entirely at the end of this period, but may still be held for any defalcation or loss which occurred during the bonded term, even though such loss were not discovered until long after this term expired. In other words, the bondsmen undertook to make good certain possible specified losses if they occurred during a certain specified time, i. e. during the treasurer's term of office. If such losses do occur, the mere fact that they are not discovered till later does not affect the liability of the bondsmen one way or the other, unless perhaps the bondsmen's liability is then barred by the statutes of limitation, or some limitation has been imposed by the terms of the bond.

This continuing liability is a disturbing feature of the personal bond and is a strong reason for its avoidance. In a surety company bond, on the contrary, this feature is taken into consideration and provided against by careful limitations. (See Form 32.)

[12] Brandt on Suretyship, § 191; Ulster Co. Inst. v. Young, 161 N. Y. 23 (1899).

[13] National, etc. Assn. v. Conkling, 90 N. Y. 116 (1882); Smith v. Molleson, 148 N. Y. 241 (1896).

PART II.—CORPORATION ACCOUNTING.

CHAPTER IX.

THE CORPORATION BOOKS AND ACCOUNTS.

§ 61. General.

In the larger corporations the books of account are under the direction of an auditor. In many corporations, however, the books of account are either kept by the treasurer or are under his direct supervision and are therefore properly considered in the present volume. The treasurer should thoroughly understand bookkeeping even though his duties do not include the keeping of the general books and accounts.

§ 62. Scope of Treatment.

In the present work it is taken for granted that the treasurer already understands the general principles of accounting and for these reasons no full presentation of elementary bookkeeping has been attempted. The intention of the present discussion is to bring out the general principles which govern modern bookkeeping, and to give such details of the various systems and the methods employed as will illustrate the application of these principles.

§ 63. The Records of a Corporate Business.

The usual records of a corporate business may be divided into six classes,—(a) the special corporate records; (b) the financial records; (c) the purchase records; (d) the sales records; (e) the cost records (in case of establishments which produce the commodities they sell), and (f) the general records.

§ 64. (a) The Special Corporate Records.

These are the books in which matters peculiar to the corporate form are recorded, and are usually in charge of the secretary. They consist of the minute book, stock certificate book, stock transfer book, stock ledger, etc. The secretary's books are outside the province of the present volume.

§ 65. (b) The Financial Records.

Since it is customary for the treasurer to have the custody of all moneys and securities, it follows that the financial records should be either kept by him or under his supervision. It is, therefore, essential that he have a thorough knowledge of their functions, and of the relation which they bear to the other classes of records, all of which form integral parts of the complete accounting system. The financial records consist of the cash receipts book and cash disbursements book, which, when combined into one book, are designated as the cash book; and the petty cash book, bank pass book, check book, bond register, coupon register, securities ledger, etc. These books are discussed in Chap. XI, "The Financial Records."

§ 66. (c) The Purchase Records.

As the name indicates, these records have to do with the purchasing department and consist of the purchase requisition blanks, goods received blanks, purchase book or its equivalent, creditors' ledger or its equivalent, and the stock ledger—in so far as the recording of purchases are concerned. This stock ledger, which provides a going inventory of the merchandise dealt in or manufactured, must not be confused with the secretary's stock-ledger in which the interests of the stockholders in the corporation are recorded. The purchase records are treated of in Chap. XII, " The Purchase Records."

§ 67. (d) The Sales Records.

All records used for recording transactions peculiar to the selling department belong in this category; e. g.,—salesmen's orders, shipping orders, duplicate bills, summary of sales, returns and allowances book, customers' ledgers, monthly analysis of selling expenses, etc. These records are treated of in Chap. XIII, " The Sales Records."

§ 68. (e) The Cost Records.

Corporations engaged in manufacturing should be able to ascertain from the accounting records the cost of producing each kind of commodity, or the cost of each job, as the case may be. This can only be accomplished by properly conducted cost records, designed to meet the requirements peculiar to the particular business. The cost records of a manufacturing system of accounts include labor tickets, monthly distribution of labor, requisitions for raw materials, stock ledger—in so far as it has to do with the quantity and cost of raw materials and supplies used in each job or process and the commodities produced,—monthly analysis of manufacturing expenses, cost ledger, etc. These records are treated of in Chap. XIV, " The Manufacturing Cost Records."

§ 69. (f) The General Records.

These records consist of the journal, general or private ledger, trial balance book, analysis of general and administrative expenses, etc., and are treated of in Chap. XV, "The General Records."

CHAPTER X.

BOOKKEEPING TERMS DEFINED.

§ 70. Bookkeeping.

Bookkeeping is the act of recording business transactions in books or their equivalent. There are two general methods of bookkeeping, (a) scientific and (b) unscientific.

(a) Scientific bookkeeping, better known as double entry bookkeeping, is the act of classifying and recording business transactions in chronological sequence, according to scientific principles which are applicable to all cases.

(b) Unscientific bookkeeping, commonly termed "single entry," is the recording of business transactions without regard to any scientific principles. The term may be applied to any plan other than double entry bookkeeping.

§ 71. Double Entry Bookkeeping.

Double entry bookkeeping derives its name from the fact that in recording transactions each entry is divided into two parts, a debit and a credit, forming a perfect equation; i. e., whenever a transaction is recorded, the debit side of some general ledger account, or accounts, is increased and the credit side of some other general ledger account, or accounts, is correspondingly increased.

From this is derived the general rule of double entry bookkeeping:—"Debit what is received and credit what is given." For instance, goods are purchased for cash, and consequently "Purchases" account should be debited (because purchased goods are received) and " Cash " account credited (because cash is given) ; or goods are sold on account, and consequently " Accounts Receivable " account should be debited (because the implied promise of the buyer is received) and " Sales " account credited (because goods are given).

§ 72. The Trial Balance.

Transactions are recorded in the different books of original entry, or books of summarization, as the case may be, in accordance with the rulings provided and the plan of the system, but the effects of these entries as to the ledger accounts are always the same,—the debits and credits of the proper general ledger accounts are equally increased after all postings are made. It follows, therefore, that the sum total of all debits in the general ledger must equal the sum total of all credits, if the entries have been properly made, and that if the balance of every general ledger account is taken, the sum total of all debit balances must equal the sum total of all credit balances. This gives rise to the trial balance, which is a list of all debit and credit balances, the totals of which should agree. If they do, it proves that all transactions have found their way into the general ledger—the book of classification—in the form of perfect equations.

§ 73. The Balance Sheet.

The trial balance includes the debit and credit balances of all open accounts appearing in the general ledger without regard to the character of these accounts. The balance sheet is composed of the debit and credit balances of the various accounts remaining after the proper transfers have been made to the " Profit and Loss " account and the balance of that account in turn transferred to " Surplus " account. It is an exhibit of the assets and liabilities of the business at a particular time.

This balance sheet, or the data required to compile it, furnishes the proper information for the initial entry or set of entries necessary to start a new system of accounts; also the condition of a business at the close of a fiscal period is reflected in its balance sheet. It will thus be seen that the data essential to the compilation of a balance sheet represent the beginning and end of scientific bookkeeping results.

When the books of account are taken over by the incoming treasurer of a corporation they should be accompanied by a formal balance sheet. This will give the initial entry or set of entries necessary to open new books if this is intended, or otherwise will afford an exhibit of the condition at that time of both the corporate books and the corporate business.

§ 74. Profit and Loss Statement.

A profit and loss statement is an exhibit showing in logical order and in comprehensive form the gross results from and expenses of operating a business for a given period of time. It should show the gross profit and how it is arrived at, the expenses of the selling department, the expenses of the general and administrative department, the net profit on business done, extraneous income and expenditure, interest charges and discounts, and net profit for the period. An excellent form for a profit and loss statement is shown in " Exhibit B " of the audit report given in Chapter XIX of the present volume.

§ 75. Records of Original Entry.

Each transaction of business must be systematically recorded and for this purpose special books and forms are provided; e. g., cash received is recorded in a cash book, sales are recorded on duplicate bills, purchases are recorded in a voucher register, notes are issued and journal entries are made to record the transactions. Any book or form used for the original bookkeeping record of a transaction belongs to the "records of original entry." It is obvious that the books of summarization, such as the various ledgers, do not belong to this class.

§ 76. Records of Summarization.

Books used for the purpose of summarizing a particular class of transactions from the records of original entry in order to arrive at classified monthly totals, and thus facilitate postings to the general ledger, are called books of summarization. To this class belong such books as the summary of sales, summary of purchases, summary of productive labor, summary of raw materials used, etc.

When duplicate bills are used, in lieu of a sales book, these bills constitute records of original entry, and customers' accounts are charged direct from them. The summary of sales book is written up from these duplicate bills in order to ascertain the total sales, total cost of sales, etc., and the footings only are posted into the general ledger.

§ 77. Assets and Liabilities.

The assets and liabilities of most businesses may be divided into four classes,—(a) fixed assets; (b) floating assets; (c) fixed liabilities, and (d) floating liabilities. For the ledger accounts coming under each of these heads, their functions and entries, see Chapter XVI, "Ledger Accounts,—Their Functions and Entries."

§ 78. (a) Fixed Assets.

Briefly, fixed assets may be defined as those which are permanent in nature, such as land, factory buildings, machinery, patterns, patent rights, horses and wagons, office equipment, store fixtures, good-will, etc.

§ 79. (b) Floating Assets.

Floating assets, as opposed to fixed assets, are those not permanent in nature. They are the ever-changing assets resulting from the carrying on of the business, such as cash, accounts receivable, notes receivable, finished products, goods in process of manufacture, raw materials, supplies, manufacturing expenses paid for in advance, merchandise, etc.

§ 80. (c) Fixed Liabilities.

Fixed liabilities include all liens on fixed assets, such as mortgages, mortgage bonds, chattel mortgages, etc.; also obligations payable several years from their date, such as debenture bonds which are not specific liens on any particular assets.

Capital stock outstanding represents a fixed obligation of the business to the stockholders, payable, however, only after dissolution and after all creditors have been satisfied. Since much of the capital stock outstanding is often issued for the equipment and good-will of a business, or issued for cash which is converted into fixed assets, it follows that capital stock issued may be logically classed amongst the fixed liabilities. So long as there is a surplus, based upon a true valuation of the assets and liabilities, the business is nominally liable to the stockholders for the par value of all outstanding capital stock. If there is a deficit the value of the capital stock outstanding is impaired and the business is liable only for the unimpaired balance (difference between par value of stock issued and amount of deficit). This liability is, as stated, conditional, only payable on dissolution and then only to the extent of the surplus assets after all other liabilities have been paid. (See § 331.)

§ 81. (d) Floating Liabilities.

Current liabilities, resulting from the carrying on of the business, belong to this category; e. g., accounts payable, notes payable, wages for labor accrued but not due, etc.

§ 82. Accounting Systems.

An accounting system consists of the books and forms used for classifying and recording all the transactions of a business. There are three kinds of systems,—(a) the "Hit-or-Miss" or "Good-Enough" system, (b) the "Coat-of-Many-Colors" system, and (c) the scientifically designed system.

§ 83. (a) The "Hit-or-Miss" or "Good-Enough" System.

The origin of a system of this sort as regards any particular business, may usually be traced to the beginning of that business. The officials, not recognizing the importance of starting with a system designed to meet the requirements of the business, leave that important feature of organization and administration to the bookkeeper, engaged at a very low salary "on account of the business being in its infancy." Obviously, the results from such a system are commensurate with the quality of skill employed in producing them.

Bookkeepers in charge of such systems do not usually remain long,—not through any fault of theirs but rather through the fault of their employers, who do not appreciate the fact that a workman cannot accomplish good results without good tools. As a consequence a succession of bookkeepers come in and each new bookkeeper changes the system to meet his own ideas,—ideas usually brought from his last engagement regardless of how widely the two businesses differ. The management, however, despite the changes in bookkeepers and bookkeeping, are never able to ascertain from the records the information they want, when they want it, or in the way they want it.

§ 84. (b) The "Coat-of-Many-Colors" System.

During the reign of this "Hit-or-Miss" (with emphasis on the "Miss") system, sundry salesmen for sundry manufacturing stationers call and extol the merits of their card systems, loose-leaf systems, bookkeeping machines, etc., all of which are made to meet all requirements, especially those peculiar to the business of the prospective buyer. The billing-machine salesman offers to design a complete system of accounts if his machine is installed, and the card-index salesman vows that bound books are a snare and a delusion and that only his wares will work wonders.

Driven to desperation from trying to secure results by means of a mongrel system, and impressed by the flowery representations of some of the many systematizing salesmen, the management usually procures from several of them several parts of a system and from this medley attempts to construct a system of accounts, which, when constructed, resembles a coat of many colors.

There are no advantages to be gained from permitting manufacturing stationers to install free systems in order to sell their goods. Such offers, if accepted, are a striking illustration of the prize package without the prize. If the goods had merit they would be utilized in the right place and in the right way through the recommendation of men who are not personally interested in the sale of the goods and who are capable of judging their utility. When a wise man is ill he secures the services of a physician; he does not try fifty-seven kinds of patent medicines each of which is guaranteed to cure all human ills. By the same token a wise business management should secure the services of a competent accountant when an effective and scientific system is desired.

It is also to be noted that there is a wide difference between a finished accountant and many of the so-called "business systematizers." A man, to be capable of designing the best system of accounts, must be a thoroughly competent accountant and auditor, a master of classification and business routine, and the possessor of original and inventive ideas as well.

§ 85. (c) The Scientifically Designed System.

The custom formerly prevailing of ascertaining the condition of the affairs of a business and the results from its operations, only when an inventory was taken, seldom more often than semi-annually and in many cases yearly, has become obsolete. The progressive business man finds it necessary to have this information at least monthly, together with other details and statistics which the records must be capable of giving accurately and consistently as needed.

It becomes necessary, therefore, in any large business, to devise an accounting method that will meet the requirements of the particular business and this oftentimes calls for a very elaborate system. After its adoption the success of this system will depend largely upon the co-operation of the departmental heads. The most scientifically designed accounting system cannot be successfully operated unless it is properly supported and the data essential to its conduct is forthcoming in accurate and consistent form. Good systems have been known to fail, but such failures rarely result from any fault of the system as designed. A scientifically designed system, like a scientifically constructed machine, will do its work if properly conducted.

CHAPTER XI.

THE FINANCIAL RECORDS.

§ 86. Record of Receipts.

In retail establishments it is usually advisable to have the financial day end at the close of the business day. In other establishments it will be found convenient to end the financial day at one o'clock. This enables the cashier—who in the smaller corporations will probably be the treasurer—to make up the deposit and include all moneys received from one o'clock of the previous day. Moneys received after that hour would be entered under the following date.

The entire receipts, whether in currency, checks or money orders, should be properly listed and deposited. If remittances are received in the form of postage stamps, these stamps should be exchanged for currency from the petty cash drawer. This currency replaces the stamps in the daily receipts, but the transaction is treated otherwise as though the stamps were purchased from the post-office. The deposit slip should be made up in duplicate and the total should agree with the total receipts for the financial day as shown by the cash receipts book.

Incoming mail should always be opened by someone outside the bookkeeping department. If the cashier does the posting to the customers' accounts, it is a good plan to have the person who opens the mail also list the remittances in a book provided for that purpose. An ordinary three-hundred-page journal serves the purpose very well. The remittances received each financial day should be recorded in the mail clerk's book in the following order,—customer's name, kind of remittance ("c" for checks, "m" for currency, "mo" for money order, etc.), and amount. If cash sales are made, each salesman should keep a separate record of his cash sales. The total cash sales should be arrived at from these records and the amount be entered in the mail clerk's book, which then becomes a general record of incoming moneys.

The total amount listed by the mail clerk during a financial day should agree with the duplicate deposit slip prepared by the cashier. Any difference should be investigated and reconciled by the mail clerk, who should then O K the duplicate deposit slip and file it in chronological order, or attach it to the top of the proper page of his book.

All remittances and cash received during the financial day should be delivered to the cashier who should record them in the cash receipts book. Columns should be provided to meet the special requirements of the business. In businesses where a very large number of daily remittances are received to be credited to accounts calling for periodical instalments, it is advisable to keep two cash receipts books—one for even and one for odd days. This plan enables the ledger clerks to do their work without interfering with the cashier.

It is always advisable to have the posting done by some one other than the cashier. If this plan is not found practical, it is well to have some one outside the bookkeeping department occasionally compare the monthly statements with the customers' ledger accounts, and then see that all statements are properly mailed.

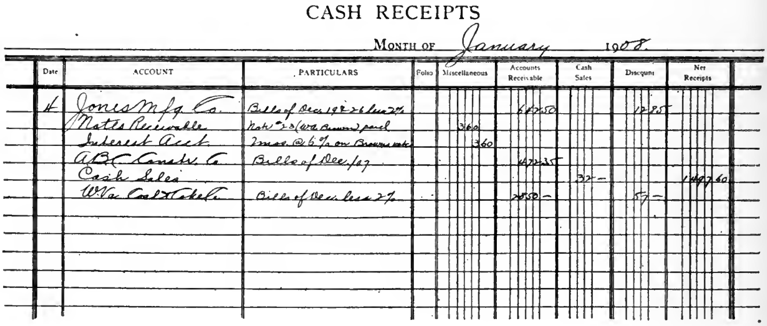
§ 87. Cash Receipts Book.

The form of cash receipts book illustrated by Cut No. 1 will meet the need of businesses in which the majority of receipts are to be credited to the customers' accounts. According to its arrangement, the amount with which the customer's account is entitled to be credited should be entered in the

"Accounts Receivable" column. If a discount is allowed, the amount should be entered in the "Discount" column. The amount of daily cash sales should be entered in the "Cash Sales" column. Any receipts other than from customers, or for cash sales, should be entered in the "Miscellaneous" column.

At the close of each financial day the sum of the daily totals of the first three columns less the daily total of the "Discount" column should be extended in the "Net Receipts" column. The items in the "Miscellaneous" column should be separately posted. The items in the "Accounts Receivable" column should be separately posted to the credit of the proper customers' accounts.

Cut No. 1. Cash Receipts Book.
(Size of Original, 12½ x 16 inches.)



CASH RECEIPTS

MONTH OF January 1908.

Date	ACCOUNT	PARTICULARS	Folio	Miscellaneous	Accounts Receivable	Cash Sales	Discount	Net Receipts
4	Jones Mfg. Co.	Bills of Dec. 19 & 26 less 2%			647 50		12 95	
	Notes Receivable	Note #23 (W. A. Brown) paid		360				
	Interest Acct.	2 mos. @ 6% on Brown note		3 60				
	A. B. C. Candy Co.	Bills of Dec./07			472 35			
	Cash Sales					32 —		1497 60
	W. Va. Coal & Coke Co.	Bills of Dec. less 2%			2850 —		57 —	

At the close of each month the footings of the "Accounts Receivable" and "Cash Sales" columns should be credited to the general ledger accounts correspondingly headed; and the footings of the "Discount" and "Net Receipts" columns should be posted to the debit of "Discounts" and "Cash" accounts, respectively, in the general ledger.

§ 88. Record of Disbursements.

An "Imprest," or ready money fund should be established, adequate to meet the demands for currency disbursements, exclusive of pay roll, for say a month. The pay roll should be provided for by means of a special check which should be drawn and cashed, its amount being charged to "Pay Roll" account.

Assuming that two hundred dollars will be sufficient for the imprest fund, a check should be drawn for that amount and converted into currency. An entry should be made charging "Imprest Fund" account in the general ledger with the amount of this check. Payments should always be made by check whenever possible, the imprest fund being used only for such disbursements as are unavoidably payable in currency.

Each currency disbursement from the imprest fund should be supported by a voucher and be recorded in the petty cash book. At the close of each month, or when the fund requires replenishing, a check should be drawn for an amount equal to the disbursements and converted into currency. This will bring the fund up to the original amount. Whenever the fund is replenished an entry should be made charging the proper accounts as shown by a summarized analysis of the disbursements, made up from the petty cash book. The vouchers should be filed numerically, according to the months.

§ 89. Cash Disbursements Book.

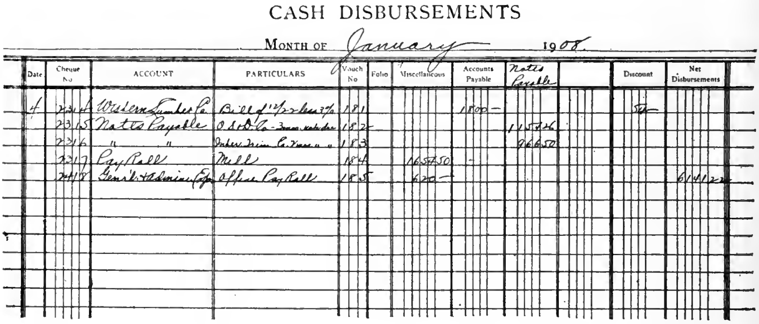
All payments, save from imprest fund, should be made by check. In recording disbursements it is necessary in many cases to provide in the cash disbursements book (See Cut No. 2) the following columns; viz., "Miscellaneous," "Accounts Payable," "Discount" and "Net Disbursements." Other columns may be added according to the requirements of the business. When a voucher register[1] is used, the first column may be omitted, and no detail postings will be made from the "Accounts Payable" column. When accounts are kept with creditors, however, it will be necessary to post the items in that column separately to the debit of the proper accounts in

[1] See § 100, "The Voucher System."

the accounts payable ledger. All items in the " Miscellaneous " column should be separately posted to the debit of the proper general ledger accounts.

At the close of each month the footing of "Accounts Payable" column is posted to the debit of the "Accounts Payable " account in the general ledger; and the footings of the "Discount" and the "Net Disbursements" column are posted in the general ledger to the credit of " Discounts " and " Cash " accounts, respectively.

Cut No. 2. Cash Disbursements Book.
(Size of Original, 12½ x 16 inches.)



CASH DISBURSEMENTS

Month of January 1908.

Date	Cheque No	ACCOUNT	PARTICULARS	Vouch No	Folio	Miscellaneous	Accounts Payable	Notes Payable		Discount	Net Disbursements
4	2314	Western Lumber Co	Bill of 12/22 less 2%	181			1800 —			36 —	
	2315	Notes Payable	O. S. D. Co - 3 mos. note due	182				1154 26			
	2316	" "	Inter. Iron Co. Note " "	183				966 50			
	2317	Pay Roll	Mill	184		1654 50					
	2318	Gen'l & Admin. Exp.	Office Pay Roll	185		620 —					6141 22

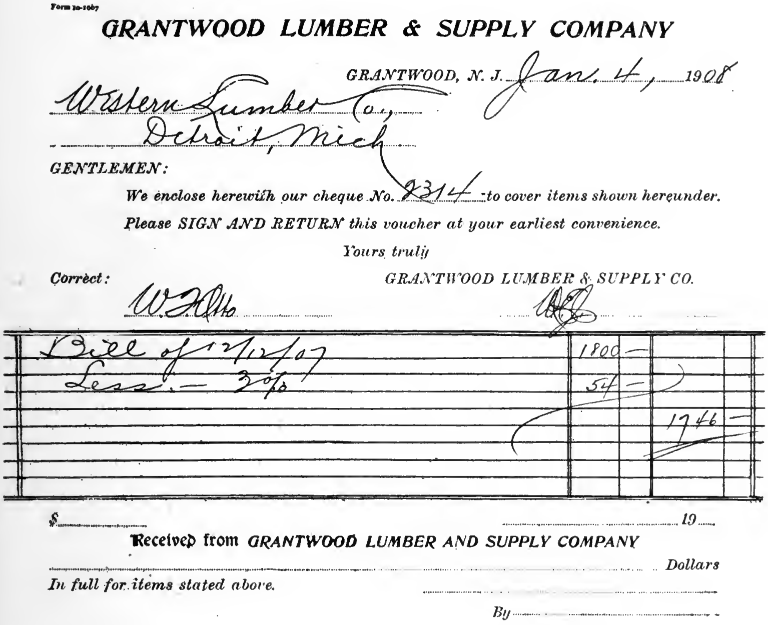
The net receipts to date, per cash receipts book, added to balance, per "Cash" account of preceding month, and diminished by net disbursements to date, per cash disbursements book, gives available bank balance.

§ 90. Evidence of Payment.

Receipts for disbursements vary in form according to the conditions. Sometimes invoices are sent out with the checks to be receipted and returned. The practice is not good. Invoices should be filed as evidence of purchase,—not as evidence of payment.

In some businesses it is not advisable to send out voucher jackets with the checks to be receipted. In such case the check itself may be made to serve as a receipt. For this purpose a blank line should be provided on the check underneath the line on which the amount of money is written. The cashier can note on this line a brief description of what the payment is for and when the check has been properly endorsed and returned by the bank it furnishes good evidence of payment.[2]

Cut No. 3. Receipt when Voucher System is Not in Use.
(Size of Original, 8½ x 7 inches.)



Form 10-1067

GRANTWOOD LUMBER & SUPPLY COMPANY

GRANTWOOD, N. J. Jan. 4, 1908

Western Lumber Co.,
Detroit, Mich.

GENTLEMEN:

We enclose herewith our cheque No. 2314 to cover items shown hereunder.

Please SIGN AND RETURN this voucher at your earliest convenience.

Yours truly

Correct: W. H. Otto

GRANTWOOD LUMBER & SUPPLY CO.

Bill of 12/12/07	1800 —	
Less — 3%	54 —	
		1746 —

$.................. ....19....

Received from GRANTWOOD LUMBER AND SUPPLY COMPANY

.... Dollars

In full for items stated above. ....

By..................

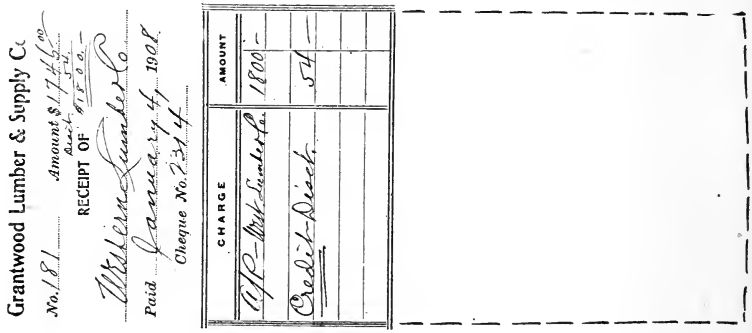
If, however, this plan is not favored, and a voucher system is in use,[3] the voucher jacket may be sent with the check and this jacket be receipted and returned. The invoices should not be sent with the jacket, but should be permanently attached to it when it has been returned.

[2] See § 230; also Forms, Chap. XXXIII.

[3] See § 100, "The Voucher System."

If a voucher system is not in use and if receipts are required for all check disbursements, the form of receipt illustrated by Cut No. 3 answers the purpose very well. One of these receipts should support each check disbursement. They should be numbered consecutively and filed accordingly. Cut No. 3A illustrates the back of the receipt when it is folded for filing.

Cut No. 3A. Receipt when Folded for Filing.



Grantwood Lumber & Supply Co

No. 181 Amount $1746.00
Disct. 54.
$1800.—

RECEIPT OF
Western Lumber Co

Paid January 4, 1908
Cheque No. 7314

CHARGE	AMOUNT
A/P-West Lumber Co.	1800—
Credit Disct.	54—

§ 91. Outstanding Checks.

If possible, the treasurer should always reconcile bank balances when the bank pass book is written up.[4] If he cannot do so, however, he should have the returned checks delivered to him direct from the bank and ascertain by actual count whether the number agrees with the number stated to have been returned by the bank. By keeping a memorandum of the number returned it is possible to verify the number outstanding. The cashier should deliver to the treasurer all checks spoiled in writing, etc. The total number of checks returned plus any spoiled checks, when deducted from the number of checks issued up to and including the last one considered in reconciling the bank balance, should leave the number out standing as shown by the cashier's reconciliation.

[4] See § 229.

§ 92. Record of Bond Issues.

Bond issues are often sold through underwriting syndicates, or by financial institutions making a specialty of the business. In such case it is customary to have the bonds issued through a trust company or other financial institution which acts as transfer agent and registrar. In that event the treasurer is relieved of the clerical work involved, as the trust company keeps the necessary records.

If conditions require that bond records be kept by the treasurer, or under his direction, it will be necessary to provide a bond register, and—if coupon bonds[5] are issued—a coupon register for each denomination.

§ 93. Bond Register.

Registered bonds are of two classes,—(1) bonds the principal and interest of which are payable to the registered owner only, interest checks being issued on the specified interest dates direct to the holders of record; (2) bonds the principal of which is payable to the registered owner only but the interest on which is represented by means of coupons and is payable to the holders of the coupons, these latter being surrendered when paid. (See § 356.)

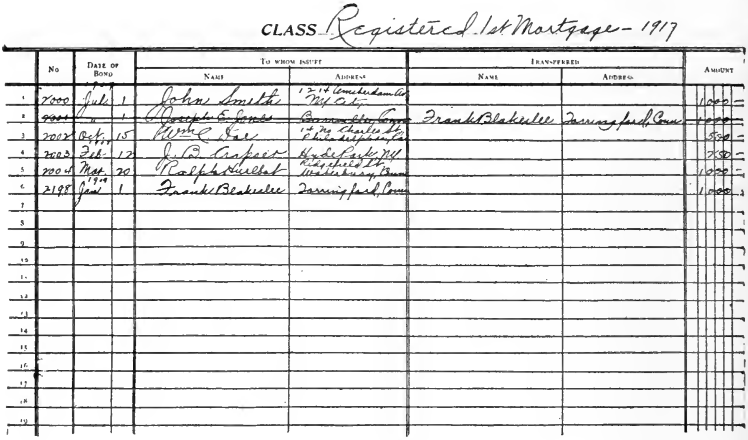
The principal record for registered bonds consists of a bond register. An index of bondholders (See Cut No. 5) is also usually maintained. The form of bond register illustrated in Cut No. 4 has twenty columns for twenty interest payments, and provides a complete record for ten-year bonds on which interest is payable semi-annually.

When a registered bond is transferred a new one is issued on surrender of the old, just as a new stock certificate is issued on surrender of the old certificate when stock is transferred. The surrendered bond is cancelled and filed, and in the bond register, a red ink line is drawn through the name and address

[5] See Chap. XXXI, "Bonds."

of the former owner, i. e. the party selling the bond, and also through the number and amount of the cancelled bond. Also the number of the new bond is written directly after the

Cut No. 4. Bond Register.



CLASS Registered 1st Mortgage - 1917

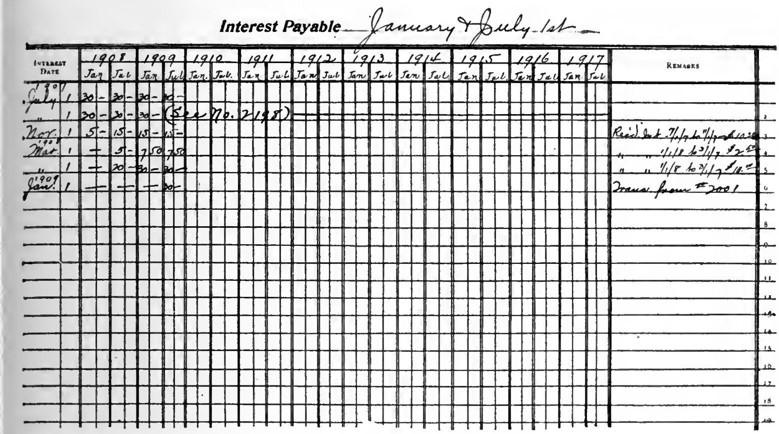
	No	Date of Bond		To whom issued		Transferred		Amount
				Name	Address	Name	Address	
1	2000	July	1	John Smith	1214 Amsterdam Av NY City			1000 —
2	~~2001~~	~~"~~	~~1~~	~~Joseph E. Jones~~	~~Bunnelle, Conn~~	Frank Blakeslee	Farmingford, Conn	~~1000 —~~
3	2002	Oct.	15	Wm C. Doe	14 No Charles St Philadelphia, Pa			500 —
4	2003	Feb.	12	J. B. Cooper	Hyde Park, NY			750 —
5	2004	Mar.	20	Ralph Hurlbut	Ridgefield St Waterbury, Conn			1000 —
6	2198	1919 Jan	1	Frank Blakeslee	Farmingford, Conn			1000 —
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								

entry of the last interest payment, on the old bond, as indicated in Cut No. 4. This while showing that the old bond has been transferred also gives the number of the new bond by which it is replaced. The name and address of the owner of the new bond is then recorded in the bond register on the first vacant line in the column headed "To Whom Issued," and the record is complete.

The difference between the footing of the "Amount" column of the bond register—or columns when the record runs over a number of pages—and the sum total of all bonds cancelled—indicated by the red ink line drawn through number, name, address and amount—should agree with the balance of the bond account in the general ledger. (See § 166.)

Interest should be computed on each bond and recorded under the proper interest period in the bond register at the time interest checks are issued. The sum total of the footings of the interest columns should agree with the aggregate amount of interest checks issued, and is charged through the cash book to "Accrued Interest on Bonds" account. (See §§ 96, 169.)

(Size of Original, 25 x 16¾ inches.)



Interest Payable January & July 1st

Interest Date		1908		1909		1910		1911		1912		1913		1914		1915		1916		1917		Remarks
		Jan	Jul	Jan	Jul	Jan.	Jul.	Jan	Jul	Jan	Jul	Jan	Jul	Jan	Jul	Jan	Jul	Jan	Jul	Jan	Jul	
1907 July	1	30—	30—	30—	30—																	
"	1	30—	30—	30—	(See No. 2198)																	
Nov.	1	5—	15—	15—	15—																	Rec'd Int. 7/1/7 to 11/1/7 $10.00
1908 Mar.	1	—	5—	7 50	7 50																	" " 1/1/8 to 3/1/7 $2.50
"	1	—	20—	30—	30—																	" " 1/1/8 to 3/1/7 $10.00
1909 Jan.	1	—	—	—	30—																	Trans. from #2001

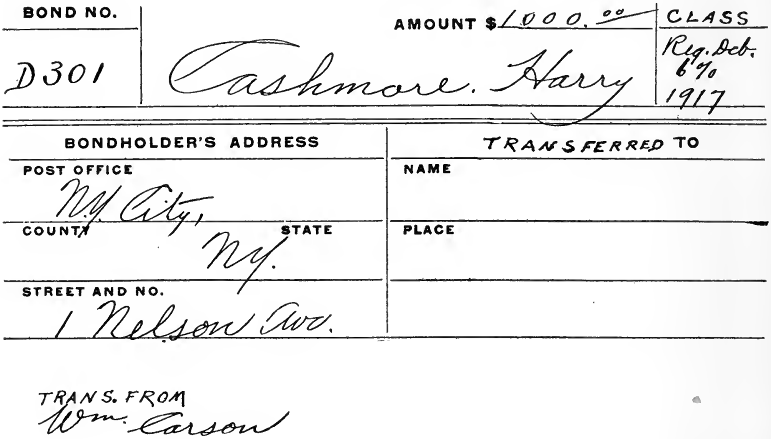
§ 94. Index of Bondholders.

An index of bondholders will be found of much convenience and is best kept on index cards as shown in Cut No. 5. When bonds are issued cards are made out in the names of the owners and are filed in proper alphabetical order. When a bond is transferred, the index card bearing the name of the prior owner is transferred to a separate file entitled "Cancelled Bonds," the new owner's name having first been noted in the space provided. An index card is then made out for the new owner and filed in its proper alphabetical position. These index cards not only afford a general index of all holders of outstanding bonds, but serve the purpose of an alphabetical transfer record as well.

When interest checks are drawn they are made out direct from the bond register. It is then advisable to arrange these interest checks alphabetically and compare the names of the payees with the names shown by the cards of the index of bondholders. This plan contemplates a double check on the accuracy of the names written in the checks and reduces to a minimum the possibility of making checks payable to the wrong person.

Cut No. 5. Index of Bondholders. Card.

(Size of Original, 3 x 5 inches.)



BOND NO.		AMOUNT $1000.00	CLASS
D301	Cashmore. Harry		Reg. Deb. 6% 1917

BONDHOLDER'S ADDRESS		TRANSFERRED TO
POST OFFICE N.Y. City,		NAME
COUNTY	STATE N.Y.	PLACE
STREET AND NO. 1 Nelson Ave.		

TRANS. FROM
Wm. Carson

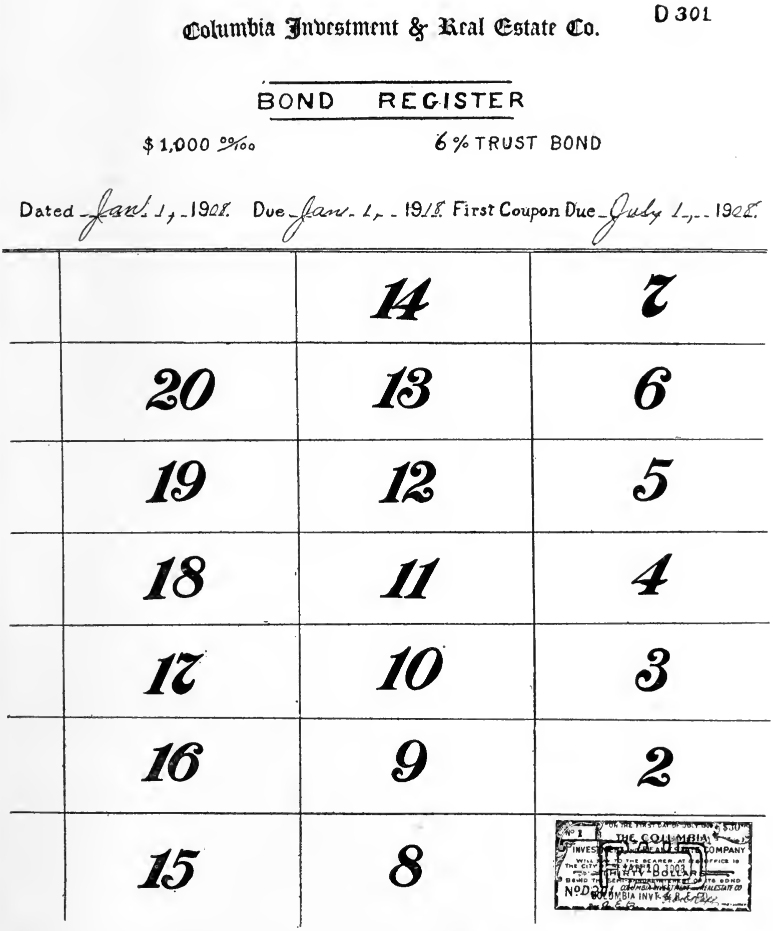
§ 95. Coupon Register.

Coupon bonds, as stated, may be registered as to principal. Interest on such bonds is, however, payable to the bearer of the proper interest coupon and not to the registered owner.

The records required for coupon bonds, if registered as to principal, are the bond register, a card index of bondholders (See Cut No. 5) and a coupon register for each denomination of bonds issued (See Cut No. 6). If coupon bonds are not registered as to principal but are transferable by delivery, the bond register is unnecessary.

The bond register for registered coupon bonds does not show interest payments but merely the ownership of the bonds, and the register shown in Cut No. 4 with the rulings for interest payments omitted, gives a very excellent form for this purpose. This register may be a bound book or a loose-leaf ledger. The bound book is preferable. The record of chese bonds is sometimes kept on cards in the form of an index.

Cut No. 6. Coupon Register.
(Size of Original, 11½ x 14 inches.)



Columbia Investment & Real Estate Co. D 301

BOND REGISTER

$ 1,000 00/100 6 % TRUST BOND

Dated Jan. 1, 1908. Due Jan. 1, 1918. First Coupon Due July 1, 1908.

		14	7
	20	13	6
	19	12	5
	18	11	4
	17	10	3
	16	9	2
	15	8	Nº 1 ON THE FIRST DAY OF JULY 190 $30 THE COLUMBIA INVES COMPANY WILL TO THE BEARER, AT OFFICE IN THE CITY BEING THE SEMI-ANNUAL INTEREST ON ITS BOND NºD301 COLUMBIA INVESTMENT REAL ESTATE CO COLUMBIA INV. & R. E. CO.

All bond issues should be recorded in the bond register in numerical order and if several denominations are issued the book should be divided into sections, one section being devoted to the bonds of each denomination. A trial balance compiled from this record should agree with the balance of the controlling bond account in the general ledger.

A separate coupon register should be provided for each denomination of bonds issued. An entire page is required for the record of each bond and all paid coupons belonging to that bond are pasted on its page in the space numbered to correspond with the particular coupon.

A glance through the coupon register will show what coupons are due but unpaid. A special bank account should be kept for the payment of coupons and the balance of this bank account should agree with the total amount of the coupons due and unpaid as shown by the coupon register.

The coupon register does not show transfers. It is intended to be a record of the coupons only. In the case of coupon bonds not registered as to principal, the coupon register will, however, serve every purpose of their record and no separate register need be kept.

§ 96. Interest Payments.

It is well to keep a special bank account for interest on coupon bonds. Oftentimes the bonds stipulate that coupons are payable at a particular bank. When interest becomes due each six months, a check should be issued for the total amount of interest and deposited to the credit of the special bank account. An entry should be made charging " Accrued Interest on Bonds " and crediting " Cash " account. As coupons are presented to the bank for payment they should be paid from this account. The aggregate amount of coupons due and unpaid should agree with the balance of the special bank account.

In the case of registered bonds, it is not necessary to maintain a special bank account for payment of interest, as this is payable to the registered owner on the interest dates stipulated in the bond. On the proper dates interest checks are made out from the bond register and mailed or otherwise delivered to the registered owner of the particular bond. The entries for interest payments should be the same as in the case of coupon bonds.

§ 97. Securities Ledger.

If a large variety of securities are owned by a company, it is advisable to provide a special ledger for keeping a detailed record of their cost and income produced. An account should be kept with each kind of security, and should show a full description of the stock, bond, mortgage, or whatever it may be, date acquired, rate of interest, date interest began from, par value, and cost. Columns should also be provided for entry of income as it becomes due, and also for entry of payment of income as it is made. If there are any charges against the income, it is advisable to keep one account with the principal and one with the income and expenditure. The securities ledger is a subsidiary book kept for statistical purposes only.

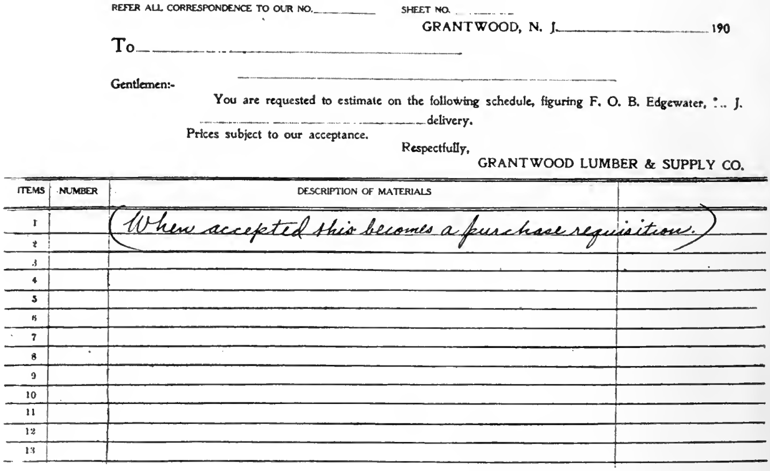
CHAPTER XII.

THE PURCHASE RECORDS.

§ 98. General.

A "Purchase Requisition" (Cut No. 7) should be made out in duplicate for all goods ordered, and, if a purchasing agent is employed, it is advisable for a third copy to be made for his files. The original requisition should be sent to the establishment from which the goods are ordered, and the duplicate delivered to the accounting department, where it should be filed.

Cut No. 7. Purchase Requisition.
(Size of Original, 10 x 13½ inches.)



REFER ALL CORRESPONDENCE TO OUR NO.________ SHEET NO.______

GRANTWOOD, N. J.________________190

To________________________

____

Gentlemen:-

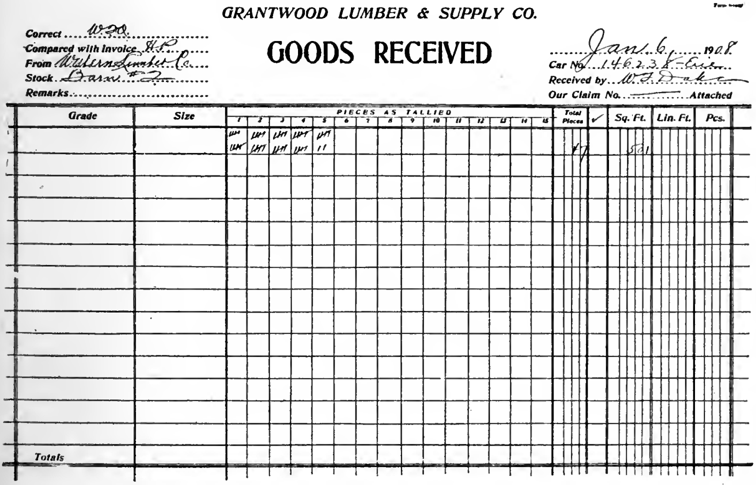
You are requested to estimate on the following schedule, figuring F. O. B. Edgewater, N. J.
________________delivery.
Prices subject to our acceptance.

Respectfully,
GRANTWOOD LUMBER & SUPPLY CO.

ITEMS	NUMBER	DESCRIPTION OF MATERIALS	
1		(When accepted this becomes a purchase requisition.)	
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			
13			

As invoices for goods ordered are received by the accounting department, they should be compared with the corresponding purchase requisitions in order to ascertain whether the orders have been properly filled. Any material differences should be reported to the purchasing agent, or, if one is not employed, to the person who ordered the goods. The extensions and footings of the invoices should be verified. The invoices and corresponding purchase requisitions should then be filed together.

Cut No. 8. Goods Received Slip.
(Size of Original, 13 x 8½ inches.)



GRANTWOOD LUMBER & SUPPLY CO.

GOODS RECEIVED

Correct W.J.D.
Compared with invoice H.P.
From Western Lumber Co.
Stock Barn #2
Remarks

Jan. 6, 1908
Car No. 146238-Erie
Received by W. J. Drake
Our Claim No. —— Attached

Grade	Size	PIECES AS TALLIED															Total Pieces	✓	Sq. Ft.	Lin. Ft.	Pcs.
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15					
		𝍸 𝍸	𝍸 𝍸	𝍸 𝍸	𝍸 𝍸	𝍸 //											47		501		
Totals																					

When the goods are received, the receiving clerk should deliver to the accounting department a " Goods Received Slip " (Cut No. 8) for each lot. These slips should be compared with the corresponding invoices and if no material differences exist, the three records (purchase requisition, invoice, and goods received slip) should be fastened together and delivered to the clerk who keeps the stock ledger, assuming that a perpetual book inventory is maintained.[1]

[1] See § 124.

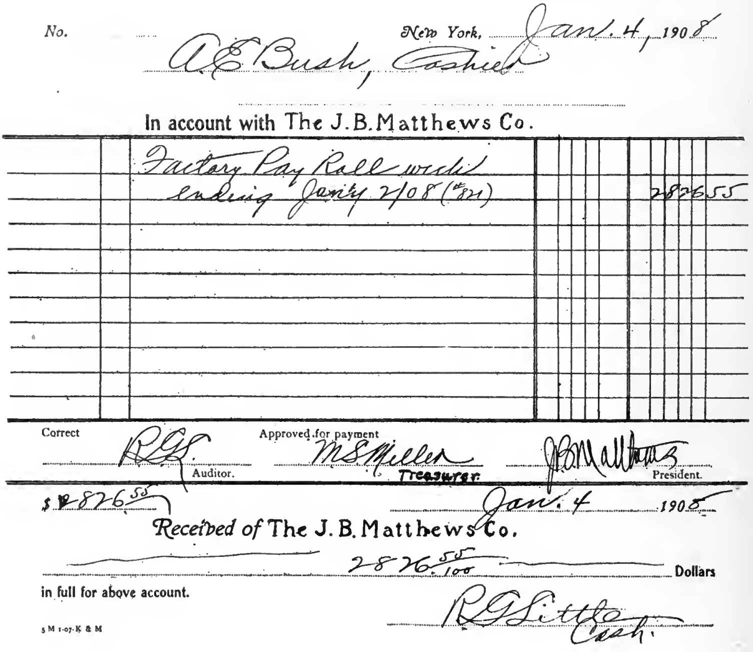
§ 99. Purchase Systems.

There are two excellent purchase systems which will be discussed in this chapter. They are known as the Voucher System and the Invoice File Sheet System. The former can be used in almost any business where purchases are made. The latter has many advantages over the former provided the number of purchases during a month are not great, say not over one hundred. It is not a practical system where a large number of purchases are made each month.

§ 100. The Voucher System.

The voucher system consists of a " Voucher Jacket " (Cut No. 9) and a " Voucher Register " (Cut No. 10).

Cut No. 9. Voucher Jacket.
(Size of Original, 8½ x 7½ inches.)



No. New York, Jan. 4, 1908

A. E. Bush, Cashier

In account with The J. B. Matthews Co.

		Factory Pay Roll week ending Jan'y 2/08 (#821)	2876 55

Correct R.G.L. Auditor. Approved for payment M. S. Miller Treasurer. J. B. Matthews President.

$ 2876 55 Jan. 4 1908

Received of The J. B. Matthews Co.

2876 55/100 Dollars

in full for above account.

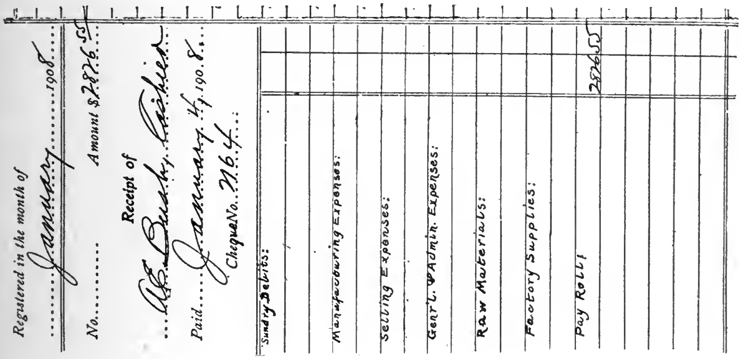
R. G. Little, Cash.

5 M 1-07-K & M

The voucher jacket is in form a statement of an account payable. It is not usually itemized, each line referring to an invoice in which the items of that particular purchase are set forth. The usual voucher jacket has a receipt blank below the statement of account, and when payment is made, this voucher jacket may be sent with the check and, when receipted and returned, serves as a complete voucher.

The voucher jackets are numbered, preferably according to month and year; e. g., the first jacket for February, 1908, should be numbered 281; the first jacket for April, 1909, should be numbered 491, the numbers running up in any one month to the total number of jackets used in that month. Unpaid voucher jackets should be filed numerically under "Unpaid Jackets." Paid jackets should be filed numerically under "Paid Jackets."

Cut No. 9A. Voucher Jacket Folded for Filing.



Registered in the month of January 1908

No. .... Amount $2876.55

Receipt of A. E. Busby, Cashier

Paid January 4, 1908

Cheque No. 764

Sundry Debits:

Manufacturing Expenses:

Selling Expenses:

Gen'l. & Admin. Expenses:

Raw Materials:

Factory Supplies:

Pay Roll 2876.55

On the back of the voucher is its number, amount, name of creditor, date of payment, check number, the distribution of its amount and such other items as the particular business may require. When filed this voucher is folded, and, when paid, the purchase invoices corresponding to the purchases listed on the voucher jacket, are attached and filed inside. The voucher register is a classified record of these voucher jackets.

The advantages of the voucher system, if properly utilized, are as follows:

The usual accounts with creditors are not necessary. Each item in the register is numbered and supported by a voucher jacket correspondingly numbered, to which is attached, or on which is recorded, proper evidence of the purchase or the expense incurred, as the case may be.

It is necessary to make only one entry in the register for the aggregate amount of invoices received from a creditor during a month, unless cash discounts are taken advantage of. In that event invoices may be registered on the 15th and 30th of each month, or not more often than every tenth day.

By keeping an index of the names of all creditors and listing the number and amount of all voucher jackets registered, ready reference may be made to transactions with creditors covering any period.

Since all expenses are recorded and distributed in the voucher register under the month in which they are incurred, it is obvious that no special columns for the distribution of disbursements are required in the cash disbursements book. The voucher register, therefore, affords a complete distribution of all expenses, purchases, etc. The cash disbursements book becomes a record of paid voucher jackets when used in connection with a voucher system.

Expense bills should be approved by the proper authority at the time they are received, delivered to the accounting department where the extensions should be verified, and placed in a temporary alphabetical file. At the end of each month they should be removed from the file, attached to voucher jackets, and recorded in the voucher register. If several bills are from one creditor all of them should be attached to one jacket and the proper distribution made on back of same. No jacket should be registered until the distribution is O K'd by the chief bookkeeper, or treasurer in case he performs that duty.

All purchase invoices should first be approved by the purchasing agent and then be delivered to the bookkeeping department. After the extensions are verified they should be attached to the corresponding purchase requisitions and filed alphabetically. As the goods received slips are delivered to the bookkeeping department, the purchase invoices corresponding thereto, together with the requisition attached, should be removed from the alphabetical file and compared with them. The invoices should then be given to the clerk who keeps the stock ledger for entry, and the requisitions and goods received slips should be permanently filed.

After the stock ledger clerk has finished using the invoices, they should be placed in a temporary file, alphabetically arranged. If it is customary to pay bills on the 10th and 25th of each month, all invoices should be removed from the file on, say, the 5th and 20th of each month, attached to voucher jackets (one jacket for each creditor), and recorded in the voucher register,—after the distributions have been approved by the proper person. The jackets registered on the 5th of a month should include only items applicable to the preceding month, and should be registered under that month. At the close of the month all purchase invoices, for which the goods have been received, and all expense bills will have been registered.

When a jacket is paid, the date paid, check number, etc., should be recorded on back of jacket in the spaces provided for that purpose. The same data should be recorded in the register, in columns specially furnished for that purpose.

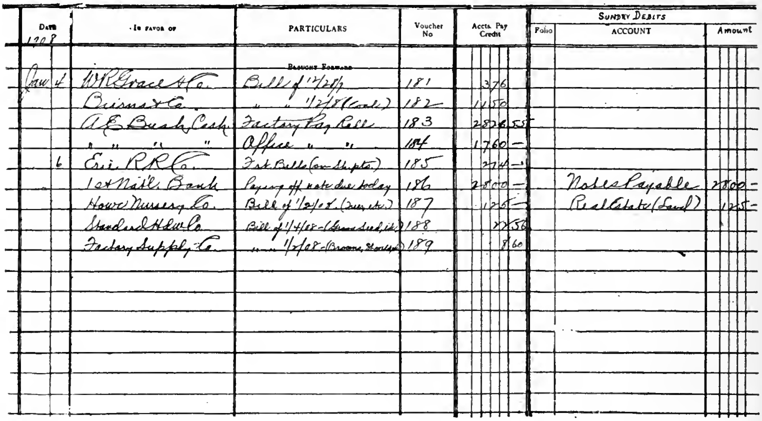
The treasurer should be provided with a list of all unpaid jackets, showing the number of the jackets, creditors' names, amounts, when due, and amounts of discounts available.

The columns illustrated by Cut No. 10 are, in the main, self explanatory. The footing of the "Accounts Payable" columns should equal the sum total of the remaining columns, and should, at close of each month, be posted to the credit of

"Accounts Payable" account in the general ledger; all items in the "Sundry Debits" column should be separately posted to the debit of the proper ledger accounts, and the footings of the remaining columns should be posted to the debit of the general ledger accounts correspondingly headed. The aggregate amount of unpaid jackets, as shown by the "Unpaid Jackets" file and also by the voucher register, should agree with the balance of "Accounts Payable" account in the general ledger, at the close of a month.

Cut No. 10. Voucher Register.

DISTRIBUTION OF VOUCHER JACKETS.



Date 1908		In favor of	Particulars	Voucher No	Accts. Pay Credit	Sundry Debits		
						Folio	Account	Amount
			Brought Forward					
Jan	4	W. R. Grace & Co.	Bill of 12/27/7	181	3 76			
		Burns & Co.	" " 1/2/8 (Coal)	182	11 50			
		A. E. Bush, Cash.	Factory Pay Roll	183	2826 55			
		" " " "	Office " "	184	1760 —			
	6	Erie R.R. Co.	Frt. Bills (on Shipts.)	185	274 —			
		1st Nat'l. Bank	Paying off note due today	186	2800 —		Notes Payable	2800 —
		Howe Nursery Co.	Bill of 1/2/08. (Nur. stk.)	187	125 —		Real Estate (Land)	125 —
		Standard Hdw. Co.	Bill of 1/4/08 - (Grass Seed, etc.)	188	22 56			
		Factory Supply Co.	" " 1/2/08 - (Brooms, Shovels)	189	8 60			

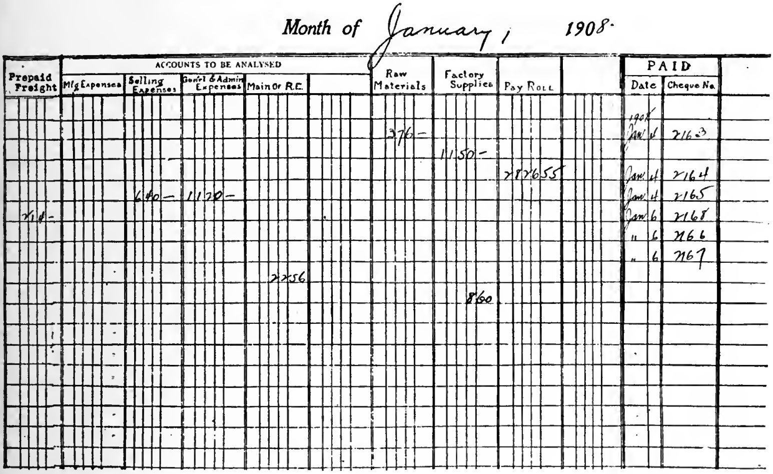
The voucher register should not be closed before about the fifth or sixth of the succeeding month in order that all bills applicable to the month may be recorded therein.

§ 101. The Invoice File Sheet System.

This purchase system consists of "Invoice File Sheets" (Cut No. 11), a "Summary of Purchases Book" (Cut No. 12), and an "Accounts Payable Ledger," which should consist of a bound book, about three hundred pages, cap size, regular ledger rulings, with index in front. There should not be enough active accounts to justify the use of a loose-leaf ledger.

Each purchase requisition received by the bookkeeping department should be attached to an invoice file sheet and filed on a post binder marked "Order Binder." As invoices are received by the bookkeeping department, the file sheet with the corresponding purchase requisition should be removed from the order binder for the purpose of comparison. The invoices should then also be attached to the file sheet which is filed on a post binder marked "Waiting Binder."

(Size of Original, 26½ x 17 inches.)

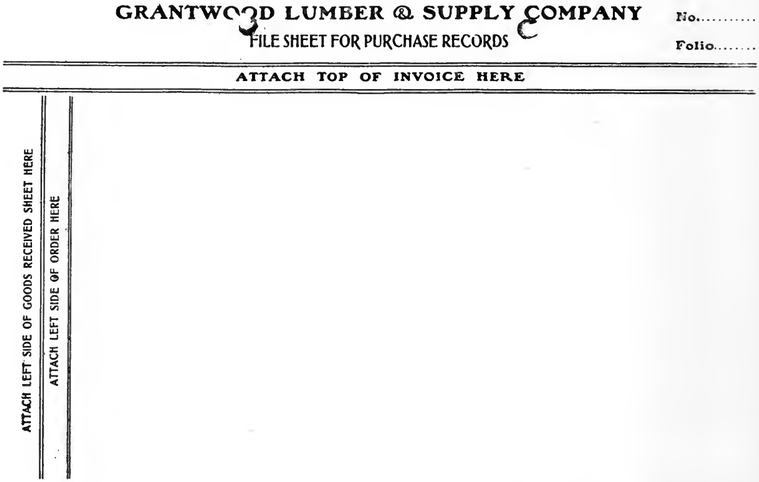


Month of January, 1908.

Prepaid Freight	ACCOUNTS TO BE ANALYSED					Raw Materials	Factory Supplies	Pay Roll		PAID		
	Mfg Expenses	Selling Expenses	Gen'l & Admin Expenses	Main or R.E.						Date	Cheque No.	
										1908		
						376 —				Jan 4	2163	
							1150 —					
								28276 55		Jan 4	2164	
		640 —	1170 —							Jan 4	2165	
214 —										Jan 6	2168	
										" 6	2166	
										" 6	2167	
				2256								
							8 60					

As the goods received slips are delivered to the bookkeeping department, the invoice file sheet with attached invoices and purchase requisitions are taken from the waiting binder and compared for the purpose of ascertaining whether all goods shown by the invoices have been received. The goods received slips are then attached to the file sheet and this completes the record of a purchase. On one file sheet are attached, in convenient form, the three elements of a purchase record;—the purchase requisition, the invoice, and the goods received slip. In some businesses the goods received slip is not used and instead the invoices are sent to the receiving department. This plan enables the employees of that department to become familiar with prices, and invites carelessness in checking up the goods received.

Cut No. 11. Invoice File Sheet.
(Regular Size, 11 x 7 inches; Large Size, 11 x 14 inches.)



GRANTWOOD LUMBER & SUPPLY COMPANY
FILE SHEET FOR PURCHASE RECORDS

No..........

Folio.......

ATTACH TOP OF INVOICE HERE

ATTACH LEFT SIDE OF GOODS RECEIVED SHEET HERE

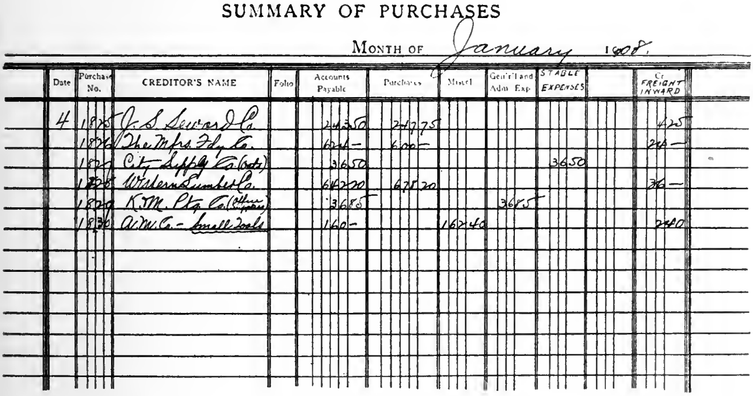
ATTACH LEFT SIDE OF ORDER HERE

The file sheets when completed should be delivered to the clerk who has charge of the stock ledger, assuming that a perpetual book inventory is maintained. When he has finished with them they should be posted to the credit of the proper accounts in the accounts payable ledger, and then be filed on a post binder marked "Complete File Sheets." From time to time the completed file sheets should be recorded in the summary of purchases book in order to ascertain, at the close of each month, the total purchases, etc.

At the close of each month the footings of the "Accounts Payable" column in the summary of purchases book—which should equal the sum total of the remaining columns—should be posted to the credit of "Accounts Payable" account in the general ledger. The items in the "Miscellaneous" column should be posted to the debit of the proper general ledger accounts. The footings of the remaining columns should be posted to the debit of the general ledger accounts correspondingly headed.

A trial balance compiled from the accounts payable ledger at the close of a month should agree with the balance of the "Accounts Payable" account in the general ledger.

Cut No. 12. Summary of Purchases Book.
(Size of Original, 10 x 16 inches.)



SUMMARY OF PURCHASES

MONTH OF January 1908.

Date	Purchase No.	CREDITOR'S NAME	Folio	Accounts Payable	Purchases	Miscl	Gen'l and Adm. Exp.	STABLE EXPENSES		Cr FREIGHT INWARD
4	1825	J. S. Seward Co.		243 50	247 75					4 25
	1826	The Mfrs. Fdy. Co.		624 –	600 –					24 –
	1827	City Supply Co. (oats)		36 50				36 50		
	1828	Western Lumber Co.		642 20	678 20					36 –
	1829	K. T. M. Ptg. Co. (office supplies)		36 85			36 85			
	1830	A. M. Co. – Small Tools		160 –		162 40				2 40

Monthly expense bills should be paid during the month in which they are incurred, and filed with the receipts. It is not advisable to open accounts in the accounts payable ledger for such items, provided it is convenient to pay them in the month in which they are incurred, as it causes too much clerical work. If it is not convenient to pay them during the month to which they are applicable, they should be recorded through the purchase records so that all expenses may be charged to the proper month, and that all liabilities may be shown by the books.

CHAPTER XIII.

THE SALES RECORDS.

§ 102. General.

The original records of sales usually consist of salesmen's orders, orders received through the mails, cash-sale slips, house-sale slips, etc. If the goods ordered are to be shipped, it is customary to make out a shipping memorandum for each order, or a bill in triplicate, the third copy being used as a shipping memorandum. The shipping clerk prepares his shipments from these records and returns them with freight receipts, bills of lading, etc., attached. If any of the goods ordered are out of stock, he should attach lists of the shortages to the proper shipping memoranda.

§ 103. Billing.

It is advisable to have all bills made out on a typewriter or billing machine. They should be compared with the orders, and the extensions should be verified, before being sent out. When a perpetual book inventory (i. e. stock ledger) is maintained, it becomes possible to ascertain the cost of all goods billed. In such cases it is well to provide an additional column on the form for duplicate bills, extending beyond the originals, and the costs should be entered in this column by the clerk who has charge of the stock ledger. It is not practical to cost each bill in this manner where the number of daily sales is large, as it causes too much posting to the stock ledger accounts.

If a book inventory is maintained it becomes necessary to arrive at the quantity of each kind of commodity sold during a month, provided each bill is not costed. This can be accomplished by providing the stock ledger clerk with a book having, say, twenty columns to the page. If there are four hundred commodities dealt in, the book should be divided into twenty equal parts or sections. The top margin of all sheets, except the first and last of each section, should be removed. The names of twenty different commodities should be written at the head of the twenty columns on inner side of the first and last sheets of each section, and such headings will be exposed and be used as a guide for all intervening pages. The quantity of each commodity sold should be entered in the proper column direct from the duplicate bill. The totals of the columns at the close of a month should represent the total quantities of the different commodities sold. It then becomes an easy matter to compute the cost of sales, and to make the proper records in the stock ledger.

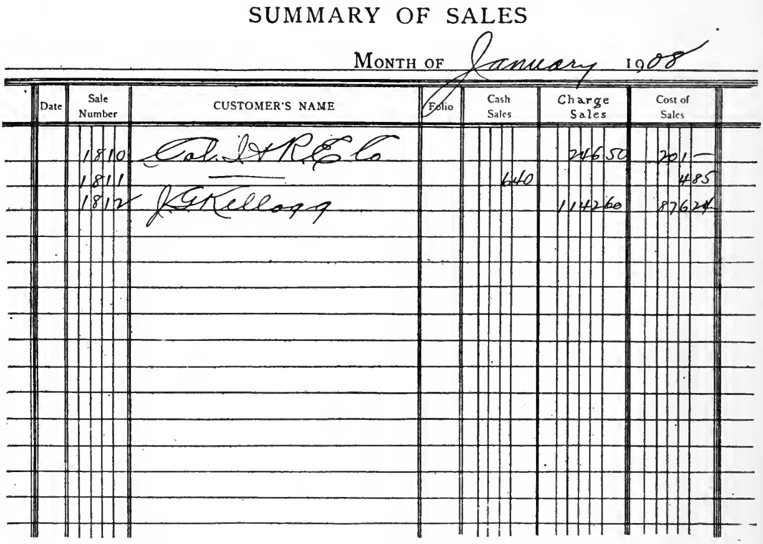
The usual printed bill head should be omitted from all but the original bills, and in its place should be provided spaces for "Folio," "Stock-ledger clerk's check mark," etc., on second copy; and spaces for shipping instructions, etc., on the third copy. Bills should be numbered consecutively, each original and its duplicates bearing the same number. The original copy goes to the purchaser. The third copy serves as a shipping memorandum. The second copy serves the purpose of a sales book, and customers' accounts should be charged from them daily. They should then be delivered to the clerk who has charge of the stock ledger, and after he has finished using them they should be filed numerically on a post binder.

§ 104. Summary of Sales.

It is necessary to arrive at the total sales of each month and for this purpose a "Summary of Sales Book" is provided (Cut No. 13).

All duplicate bills should be recorded in this book, in numerical order. The rulings illustrated by Cut No. 13 provide for all sales being credited to one sales account. When it is desired to subdivide the sales, an account may be kept in the general ledger for the sales of each department,—in which event a column should be provided in the summary of sales for the sales of each department, and another for the cost of these sales. In other words, there might be two, three or four sales columns with corresponding cost-of-sales columns in place of one of each as shown in the cut, but the same principles govern.

Cut No. 13. Summary of Sales Book.
(Size of Original, 8½ x 15½ inches.)



SUMMARY OF SALES

MONTH OF January 1908

Date	Sale Number	CUSTOMER'S NAME	Folio	Cash Sales	Charge Sales	Cost of Sales
	1810	Col. I & R. E. Co.			246 50	201 —
	1811	—		6 40		4 85
	1812	J. G. Kellogg			1142 60	876 24

In some businesses it is desirable to divide the sales geographically. This may be accomplished by using a loose-leaf summary of sales book, with tabs arranged on the right-hand margin of pages on which are printed the names of the different states, or selling territories. The sales in each state or territory are entered on the proper page and the totals of each page are carried to a recapitulation sheet where the grand totals are shown at the close of each month.

At the close of each month the footing of the "Cash Sales" and "Charge Sales" columns should be posted to the debit of "Cash Sales" and "Accounts Receivable" accounts, respectively, and credited to "Sales" account. The footing of the "Cost of Sales" column should be debited to "Sales" account and credited to "Purchases" account or "Finished Products" account as the case may be—depending on whether the company is a manufacturing or trading concern. If duplicate bills are not costed, the "Cost of Sales" column should be omitted.

§ 105. Customers' Ledger.

A loose-leaf ledger, or ledgers, may usually be used to advantage for this purpose as it permits the weeding out of dead accounts, and pages that are filled. It also enables an account to occupy the same position in the ledger indefinitely, regardless of the fluctuations in the number of active accounts.

A trial balance should be compiled from this ledger at the close of each month, and should agree with the balance of the "Accounts Receivable" account in the general ledger.

CHAPTER XIV.

MANUFACTURING COST RECORDS.

§ 106. Importance of Accurate Costs.

The importance of ascertaining accurate production costs cannot be overestimated. A cost system accurately conducted enables the management (1) to make accurate and consistent estimates of gross profits; (2) to intelligently meet competition; (3) to know which lines pay best; (4) to ascertain the efficiency of the production department and judge the work of the foremen, etc.; (5) to note fluctuations in the cost of turning out duplicate orders, and to trace the causes of such fluctuations; and (6) to ascertain the gross profit on monthly sales. If manufacturing is done on special order, and not for stock, the gross profits on each special job may be shown.

Many companies make a practice of figuring costs arbitrarily. The few cost records they keep are independent of the general bookkeeping system and are mere memorandum consisting of guesses. They never know how closely they guess because they never know the true costs of production. Such methods are entirely obsolete, inefficient, and have no place in modern factory administration. If every treasurer of a manufacturing company understood the principles of cost accounting, there would be less failures recorded, and more consistent pricing of products.

§ 107. Requirements of a Cost System.

A cost system for a manufacturing establishment should enable the management to ascertain at the close of each month the following information; viz.,—(a) The quantity and cost of raw materials, factory supplies, and finished products on hand; and the cost of goods in process. (b) The gross profit on sales. (c) The expenses of the selling department. (d) The expenses of the administrative department. (e) The net profit from sales. (f) Miscellaneous income, interest charges, etc. (g) The general condition of affairs, i. e., a statement of the assets and liabilities, or balance sheet.

§ 108. (a) Raw Materials, Supplies, and Finished Products.

Raw Materials. Any commodity which forms a part of the finished product belongs under this heading. A manufacturer of worsted suitings may find it cheaper to manufacture yarn than to buy it in the open market. The yarn is a finished product in so far as the Yarn Department is concerned but when requisitioned by the Weaving Department it is considered a raw material, or a semi-raw material to be technically exact.

Factory Supplies. This term includes coal, coke, lubricating oils, waste, belting, packing, small repair parts, small tools (hammers, shovels, saws, brooms, etc.), etc.

Finished Products. An article becomes a finished product when it is ready for delivery to the purchaser. Before that stage it is considered as being in process of manufacture.

§ 109. (b) Gross Profit on Sales.

The difference between the sales and the production cost of the goods sold during a month represents the gross profit on sales.

§ 110. (c) Expenses of the Selling Department.

All expenses incurred in maintaining the selling department belong under this heading; e. g., salesmen's salaries, agents' commissions, salesmen's expenses, credit-man's salary, commercial agency fees, advertising, expenses of circularizing, etc.

The aggregate of these expenses reflect the cost of marketing the products, or of creating a market for products.

§ 111. (d) Expenses of the Administrative Department.

All expenses not directly applicable to either the production or selling departments, but which are general to the business considered as a whole, belong under this heading. They consist of those expenses which are not materially affected by the volume of business done; e. g., officers' salaries, corporation taxes, office help, office supplies, general postage, telephone charges, legal fees, etc.

§ 112. (e) Net Profit on Sales.

This represents the difference between the gross profit on sales and the total expenses of the selling and administrative departments. Interest on borrowed capital, cash discounts on purchases and sales, miscellaneous income, etc., should be deducted from or added to net profits, as the case may be, in order to ascertain the net results from operations.

§ 113. Elements of Cost.

There are three elements which enter into the cost of a finished product; viz., productive labor, raw materials and manufacturing expenses—sometimes designated as "Over-Head Expenses," "Indirect Expenses," etc. There are two general methods employed in arriving at the cost of production; viz., the "Production-Order" method and the "Process" method, which are discussed in the two following divisions of the present chapter.

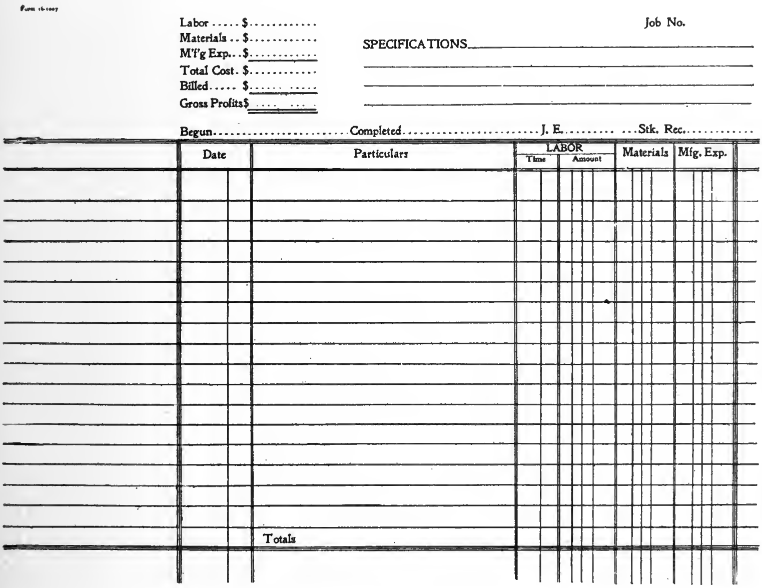
(1) THE PRODUCTION ORDER METHOD.

§ 114. Procedure.

This method provides for arriving at the cost of each job. A production order is issued to the superintendent for each lot of goods to be produced. The order should be given a permanent number, and be registered in a book kept for the purpose. It should specify the style, class, etc., of the commodity and the quantity to be produced. The superintendent has charge of making out the sub-production orders, laying out work, etc.

Cut. No. 14. Simple and Condensed Form of Cost Ledger Sheet.

(Size of Original, 11 x 8½ inches.)



Form 16-1007

Labor ..... $............
Materials .. $............
M'f'g Exp... $............
Total Cost. $............
Billed..... $............
Gross Profits $............

Job No.

SPECIFICATIONS________________

Begun......................Completed......................J. E.......... ...Stk. Rec.............

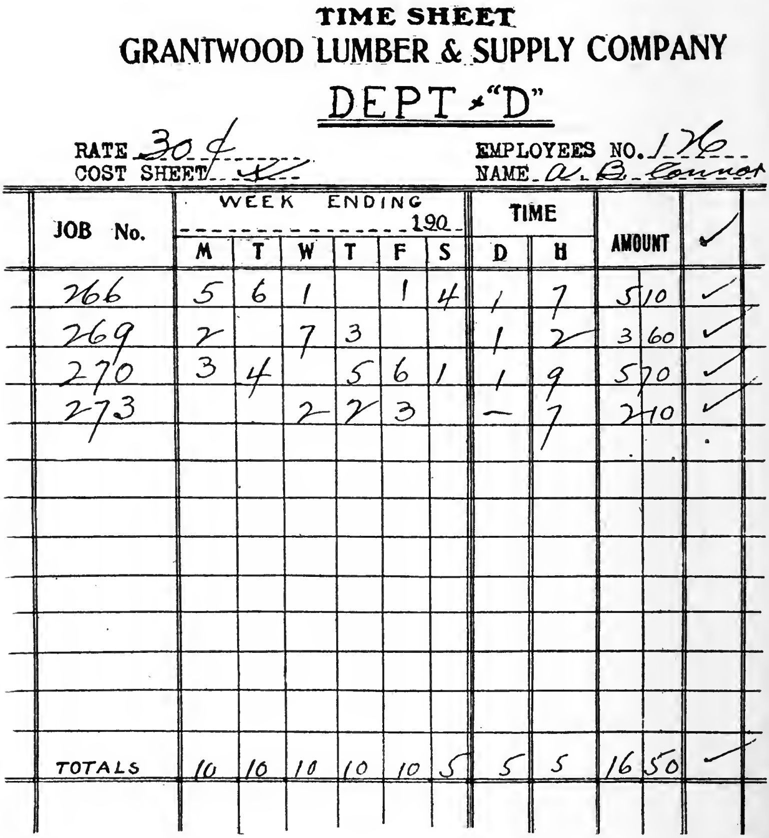
	Date	Particulars	LABOR		Materials	Mfg. Exp.
			Time	Amount		
		Totals				

A cost sheet should be allotted to each job. The foregoing cut illustrates a condensed form for a cost ledger sheet.

§ 115. (1) Factory Wages and Salaries.

Under the production-order method it is necessary to secure the time which each workman devotes to a job. This may be done by means of time recording devices, job tickets, etc. Cut No. 15 illustrates a simple form for a time sheet. It covers one workman's time for a week, and allows for his working on twelve different jobs. These time sheets may be

Cut No. 15. Simple Form of Workman's Weekly Time Sheet.
(Size of Original, 6 x 6½ inches.)



TIME SHEET
GRANTWOOD LUMBER & SUPPLY COMPANY
DEPT "D"

RATE 30¢ EMPLOYEES NO. 176
COST SHEET X NAME A. B. Connor

JOB No.	WEEK ENDING 190						TIME		AMOUNT		✓
	M	T	W	T	F	S	D	H			
266	5	6	1		1	4	1	7	5	10	✓
269	2		7	3			1	2	3	60	✓
270	3	4		5	6	1	1	9	5	70	✓
273			2	2	3		—	7	2	10	✓
TOTALS	10	10	10	10	10	5	5	5	16	50	✓

printed on heavy stock, and, when in use, be kept in numerical order by the foreman of each department, or each workman may keep his own time sheet and turn it in weekly,—depending upon the intelligence of the laborers employed. All time sheets should be turned in at the end of a month, regardless of whether that marks the end of a week.

The time clerk should compute the cost of time as shown by the time sheets. If jobs are completed in a short time, and if the number of workmen are few, the time sheets may be posted direct on the cost sheets. Otherwise it is advisable to provide a monthly time sheet for each job with six double columns (allowing for five weeks and the fraction of a week) and one to the extreme left for employees' numbers. The double columns should be headed "Time" and "Amount." The footings of the "Amount" columns should be posted in the aggregate to the proper cost sheets at the close of each month. The sum total of all monthly time sheets should, at the close of each month, be charged to "Manufacturing" and credited to "Pay Roll" accounts in the general ledger as per monthly journal entry No. 1.*

It is advisable to allot permanent shop orders to represent the following classes of labor charges; viz., repairing machinery, cleaning machines, lost time, maintenance of real estate (work on lawns and roadways, repairing buildings, etc.), miscellaneous non-productive labor, etc. Monthly time sheets should also be kept for recording the cost of such classes of labor charges, which should be reported in the same manner as time devoted to regular jobs. The totals of these monthly time sheets should be used in making a monthly journal entry as illustrated by No. 2.*

The monthly cost of wages and salaries of superintendent, foremen, engineer, firemen, stable-men, drivers, watchmen, etc., may easily be computed at the close of each month, and such items should be used in making a monthly journal entry as

* See Cut No. 18 in Chap. XV.

illustrated by No. 3.* Since all moneys paid for factory wages and salaries are charged to "Pay Roll" account, it follows that the balance of that account, after monthly journal entries numbers 1, 2 and 3* are posted, should represent the cost of factory wages and salaries accrued but not due.

From the foregoing it will be seen that the cost of all productive labor is charged to the jobs which have been active during the month in accordance with the time actually devoted to them; and that the cost of non-productive labor is charged to "Manufacturing Expenses," "Maintenance of Real Estate," "Selling Expenses," and "Administrative Expenses" according to the nature of the service rendered. Thus all factory labor is accounted for and properly apportioned.

It is the duty of the treasurer or other person responsible for payments, to see that every possible precaution is taken in connection with the weekly paying off of factory labor. The person who makes up the pay roll should not pay off. Some one should do this who does not come in contact with the time records. If this cannot be arranged, it is well to devise means of checking the work of the pay clerk. This may sometimes be done by having the foreman of each department distribute brass checks, distinctively marked, to the workmen of his department the day prior to the pay-day, reporting to the treasurer the number of checks distributed and returning the surplus checks. The clerk who pays off should collect a check for each envelope handed out, and the number of checks returned by him should agree with the number of envelopes made up, and with the number of checks distributed, assuming that all envelopes are given out.

§ 116. (2) Materials and Factory Supplies Used.

All raw materials and factory supplies, excepting fuel, should be in charge of one or more storekeepers. Requisitions

* See Cut No. 18 in Chap. XV

should be given to the storekeeper when materials or supplies are to be used, showing the quantity and kind of commodities required, the job number as an indication of what they are required for, and the signature of the person who requires them. The requisitions should be delivered to the bookkeeping department where they should be arranged according to job and standing-shop-order numbers. The clerk who has charge of the stock ledger should post the quantities of materials and supplies used direct from these requisitions, at which time he should extend the cost of items shown thereon.

The total cost of raw materials used during a month, as shown by the requisitions, should be debited to " Manufacturing " account and credited to " Raw Materials " as illustrated by monthly journal entry No. 7.*

At the close of each month all requisitions applicable to a particular job should be charged to that job on the cost sheet, and all requisitions applicable to standing shop orders should be charged accordingly by means of a monthly journal entry similar to No. 4.* This monthly journal entry also provides for the cost of fuel used, as reported by the engineer.

§ 117. (3) Manufacturing Expenses.

Each job having been charged with the cost of productive labor and raw materials used during a month, it now becomes necessary to apportion the manufacturing expenses over all jobs which have been active. There are various ways of doing this. If labor costs invariably exceed by a large margin the cost of raw materials, it is customary to use the total cost of productive labor as a basis for distributing manufacturing expenses. If the cost of raw materials forms an important part of the total production costs, it is advisable to use the combined cost of productive labor and raw materials as a basis. There are other methods used, but one of the two explained above

* See Cut No. 18 in Chap. XV

will usually afford an equitable basis for apportioning indirect charges.

By means of the monthly journal entries, Nos. 2, 3, 4 and 6* and of charges made during a month, the " Manufacturing Expenses " account in the general ledger will have been charged at the close of each month with the cost of indirect labor, factory supplies and fuel used; net maintenance of real estate; monthly reserve for depreciation of machinery and equipment; monthly proportion of insurance premiums applicable to machinery, raw materials, etc.; and sundry items during a month which are chargeable direct to the account.

The monthly journal entries should be posted as fast as they are made. In distributing the balance of " Manufacturing Expenses " account per general ledger, it is advisable to have paper specially ruled with four columns headed as follows: " Job No.," " Productive Labor," " Raw Materials," and " Manufacturing Expenses."

Step No. 1 is as follows: The total cost of productive labor charged to each job during a month is entered in the " Productive Labor " column on a line with the proper job number; and the total cost of raw materials charged to each job during a month is entered in the " Raw Materials " column opposite the proper job numbers. The footing of the " Productive Labor " column should agree with the amount used in monthly journal entry No. 1;* and the footing of the "Raw Materials" column should agree with the amount used in monthly journal entry No. 7.*

Step No. 2 is accomplished by dividing the manufacturing expenses for the month by the cost of productive labor, as shown by the footings of the " Productive Labor " column referred to in the foregoing paragraph. The quotient should be carried to at least four places, and represents the relation which manufacturing expenses bear to productive labor, this latter being used here as a basis for distributing indirect charges

* See Cut No. 18 in Chap. XV.

instead of using productive labor and raw materials combined.

Step No. 3 consists of multiplying the cost of productive labor applicable to each job by the quotient, referred to above. The separate results should represent the proportion of manufacturing expenses chargeable to each job, and should be recorded in the "Manufacturing Expenses" column of the sheet explained in step No. 1. The footing of that column should equal the balance of the "Manufacturing Expenses" column per general ledger. If a small difference exists it may be arbitrarily added to one of the jobs. Monthly journal entry No. 9* should then be made and posted, thus causing the "Manufacturing Expenses" account to balance.

Step No. 4, the final one, consists of posting all items in the "Manufacturing Expenses" column to the proper cost ledger sheets (Cut No. 14), which will then show the cost of any job up to and including the last day of the month. The total cost of all jobs completed during a month should be listed and the footing of that list should be used in making monthly journal entry No. 10.*

(2) THE PROCESS METHOD.

§ 118. When Applicable.

The "Production Order" method can be operated only in cases where a particular job can be so identified from start to finish that workmen can report the time devoted thereto. Companies engaged in the manufacture of beer, ales, liquors, flour, chemicals, etc., are therefore unable to apply the method in arriving at production costs, since one lot cannot be distinguished from another and the reporting of workmen's time on each is impossible. One batch follows another and at times several batches are combined in one inseparable mass. In such cases it is necessary to employ the "Process Method," which

* See Cut No. 18 in Chap. XV.

consists of classifying the processes in accordance with the methods of production. The processes may be designated by numerals, letters of the alphabet, or by their technical name.

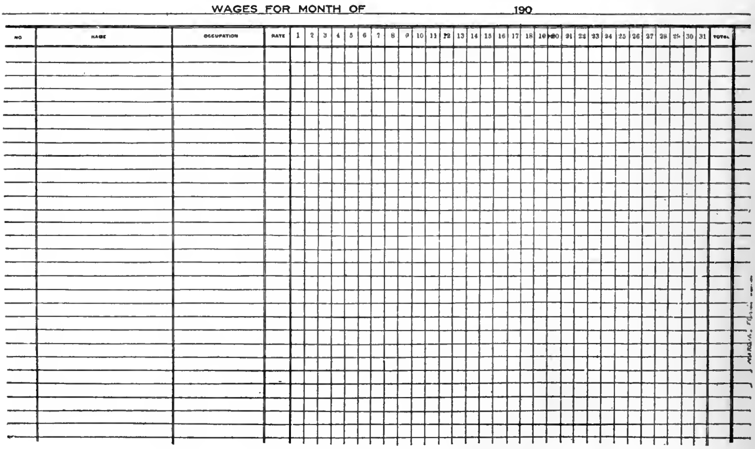
In some cases either the production order or the process method may be used;—the production order method is then the preferable and should be employed.

§ 119. (1) Productive Labor.

It is necessary for the bookkeeping department to be furnished with a record of all time devoted to each process during a month. This may be accomplished by means of having the different processes printed on a time ticket made to fit the particular time recording device employed in the establishment. Each workman should "ring-up" in the morning so that the time will show opposite the process he is working on. He should continue to record his time "in" and "out" opposite the same process until he is put on another one at which time he should "ring-up" opposite that process.

The time of each workman should be classified by the

Cut No. 16. Monthly Time Sheet. "Process Method."



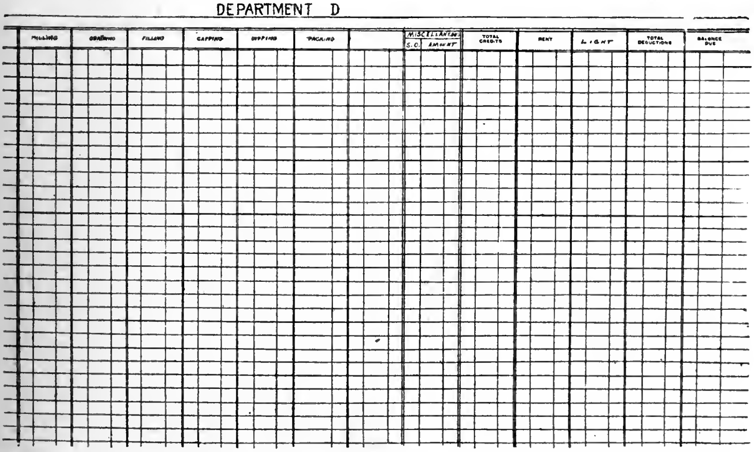
WAGES FOR MONTH OF 190

NO	NAME	OCCUPATION	RATE	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	TOTAL

bookkeeping department according to processes. This may be accomplished by means of monthly time sheets as illustrated by Cut 16. The footings of the different process columns, at the close of a month, should represent the cost of productive labor devoted to each of the processes. Where several kinds of commodities are produced it may be that a different series of processes will be required for each one. In such cases separate monthly time sheets will be required for each commodity.

The " Miscellaneous " column shown in Cut No. 16 is for the purpose of recording the cost of labor devoted to standing shop orders, salaries of superintendent and foremen, lost time, etc. An analysis of this column should be prepared at the close of each month in order to arrive at the figures required in making monthly journal entries Nos. 2 and 3.* The sum total of columns to the left of the " Miscellaneous " column should represent the cost of productive labor and be used in making monthly journal entry No. 1.* The footing of the " Rent " column represents the aggregate rents chargeable to workmen and should be charged to "Pay Roll " account and credited to

(Size of Original, 28 x 17 inches.)



DEPARTMENT D

	MILLING	GRAINING	FILLING	CAPPING	DIPPING	PACKING		MISCELLANEOUS		TOTAL CREDITS	RENT	LIGHT	TOTAL DEDUCTIONS	BALANCE DUE
								S.O.	AMOUNT					

* See Cut No. 18 in Chap. XV

" Maintenance of Real Estate." The footing of the " Light " column should be charged to " Pay Roll " and credited to " Manufacturing Expenses."

It is necessary for the bookkeeping department to be furnished with a record of work accomplished under each process. This may be done by means of daily reports from foremen showing, say, the number of pounds milled, grained, filled, capped, dipped, packed, etc. These daily reports should be summarized on sheets in order to secure the requisite monthly totals.

At the close of each month the labor cost-per-pound (or whatever the unit may be) of finished goods is arrived at by means of using the monthly quantities, referred to in the previous paragraph, in connection with the cost of productive labor applicable to each process as shown by the monthly time sheets. Thus, assuming that 200,000 lbs. were milled, 190,000 lbs. grained, 160,000 lbs. filled, 140,000 lbs. capped, dipped and packed; by referring to the monthly time sheet the cost of productive labor devoted respectively to milling, graining, filling, etc., will be found. Divide the cost of milling by 200,000 and the quotient will represent the cost-per-pound of milling. In a like manner the cost-per-pound of graining, filling, etc., should be computed. By adding the cost-per-pound of milling, graining, filling, capping, dipping, and packing, a total cost-per-pound of finished goods is arrived at, so far as productive labor is concerned. There will, of course, be some milled but not grained, some grained but not filled, and some filled but not capped. The labor expended on these unfinished products is what constitutes the labor cost of goods in process. The quantity and cost of goods milled but not grained, grained but not filled, etc., must be carried forward and used in figuring the costs for the following month under the heading, "In Process Last Month."

§ 120. (2) Materials Used.

All materials used should be reported to the bookkeeping department, and posted to the credit of the proper accounts in the stock ledger. In posting these credits it is advisable to alternate the color of inks each month; i. e., use black ink for even and green ink for odd months. At the close of each month a statement should be compiled from the stock ledger showing the quantity and cost of raw materials used. (Supplies used should be handled as explained in § 116.) The total cost should be used in making monthly journal entry No. 7.*

In order to ascertain the cost-per-pound of raw materials in each pound of finished products, it is necessary to proceed along the lines suggested by the following formula:—

Processes.	In process last month.		Used during month.		In process this month.		Applicable to Fin. Products.	
	Quan.	Cost.	Quan.	Cost.	Quan.	Cost.	Quan.	Cost.
1								
2								
3								
4								
5								
6								
7								
etc.								

It is necessary to know the raw materials which go into the different processes in order to use the foregoing formula. Very often all materials are used in the first process. In that case it is only necessary to add the cost of materials used during the month to the cost of materials in process at close of the previous month, and deduct from that sum the cost of materials in process at the close of the month. The difference should be the cost of materials represented in the goods finished during the month, and by dividing it by the quantity of goods

* See Cut No. 18 in Chap. XV.

actually finished, the cost-per-pound of raw materials in each pound of finished product will be represented by the quotient.

§ 121. (3) Apportioning Manufacturing Expenses.

The "Manufacturing Expenses" account has been fully dealt with in § 117 of the present volume.

At the close of each month the balance of "Manufacturing Expenses" account must be equitably divided between the goods in process and the goods finished during the month. Assuming that the "Man-hour" method affords the most equitable basis for distributing manufacturing expenses; then the total hours of productive labor for the month forms the basis (denominator). Divide the balance of the "Manufacturing Expenses" account (after all monthly journal entries applicable thereto are posted) by that basis and the quotient, carried to at least four places, will represent the ratio which manufacturing expenses bear to productive time. Multiply the total hours devoted during the month to milling by the quotient, and the result will represent the proportion of manufacturing expenses applicable to that process. Separately multiply the hours devoted to the remaining processes (during the month only) by the quotient referred to, and the sum of the results should equal the balance of the "Manufacturing Expenses" account and be used in making monthly journal entry No. 9.*

In order to properly divide the expenses between goods in process at the close of the month and the goods produced during the month, it will be necessary to use the "results" referred to in the preceding sentence in connection with the formula given on the following page.

The items in the second column represent the results obtained from multiplying the hours devoted to each process during the month by the ratio of expenses to productive time expressed in hours. The items in the third column are arrived

* See Cut No. 18 in Chap. XV.

Processes.	Cost of manufacturing expenses applicable to work in process at close of last month.	Cost of manufacturing expenses applicable to work accomplished during month.	Cost of manufacturing expenses applicable to work in process this month.	Cost of manufacturing expenses applicable to finished goods.
1	$850.00	$4,600.00	$900.00	$4,550.00
2	600.00	3,800.00	500.00	3,900.00
3	200.00	2,200.00	300.00	2,100.00
4	300.00	1,200.00	200.00	1,300.00
5	300.00	1,500.00	200.00	1,600.00
6	....	800.00	....	800.00
etc.				
Totals	$2,250.00	$14,100.00	$2,100.00	$14,250.00

at by multiplying the productive time (in hours) applicable to work in process by the ratio. (The productive time devoted to work in process is computed at the time of figuring labor costs.) The footing of the final column should be divided by the total quantity of goods (of a given kind) produced during the month in order to ascertain the cost-per-pound of manufacturing expenses represented in each pound of finished products of a given kind.

This cost-per-pound should be added to the cost-per-pound of productive labor (See § 119) and raw materials (See § 120), thus arriving at the total cost-per-pound of a given class of finished goods. Multiply the total cost-per-pound by the number of pounds produced during the month in order to arrive at the total cost of a given kind of goods finished. The result should be used in making monthly journal entry No. 10.*

The clerk in charge of the stock ledger will have posted the quantity of each class of goods produced. He should insert the cost-per-unit as soon as it is computed.

* See Cut No. 18 in Chap. XV.

CHAPTER XV.

THE GENERAL RECORDS.

§ 122. Books Included.

The records treated in the present chapter include the journal, stock ledger, analysis book, general ledger, subsidiary ledgers, and trial balance book.

§ 123. The Journal.

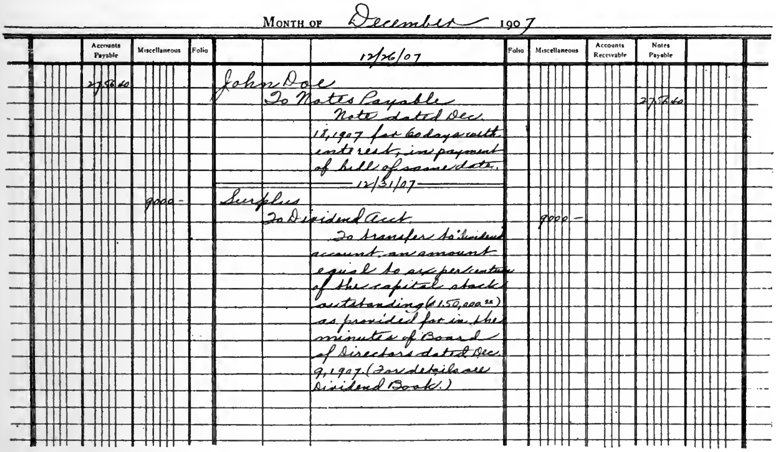
There are certain transactions which cannot be properly recorded through either the financial, purchase, sales, or manufacturing records, such as the giving or receiving of notes to apply on account; goods returned from, or allowances made to customers (unless a record is kept for that particular purpose); claims allowed by creditors; adjustments of general ledger accounts; closing entries (usually made semi-annually), etc. These entries are made in the journal, a book used for recording such transactions as cannot be passed through other records of original entry, and for recording all transfers from one account to another.

Each entry in the journal should be supported by sufficient explanation to convey a clear understanding to anyone who may have occasion to refer to it. A skeleton journal entry means very little except to the one who makes it, and often becomes an enigma to him after it gets cold.

The journal shown in Cut. No. 17 is an excellent form. The columns to the left are for debits and to the right for credits. Two entries are shown to illustrate the functions of the rulings.

All items in the "Miscellaneous" columns should be posted in detail; the remaining columns should be posted in totals at the close of each month.

Cut No. 17. Journal.
(Size of Original, 13 x 16 inches.)



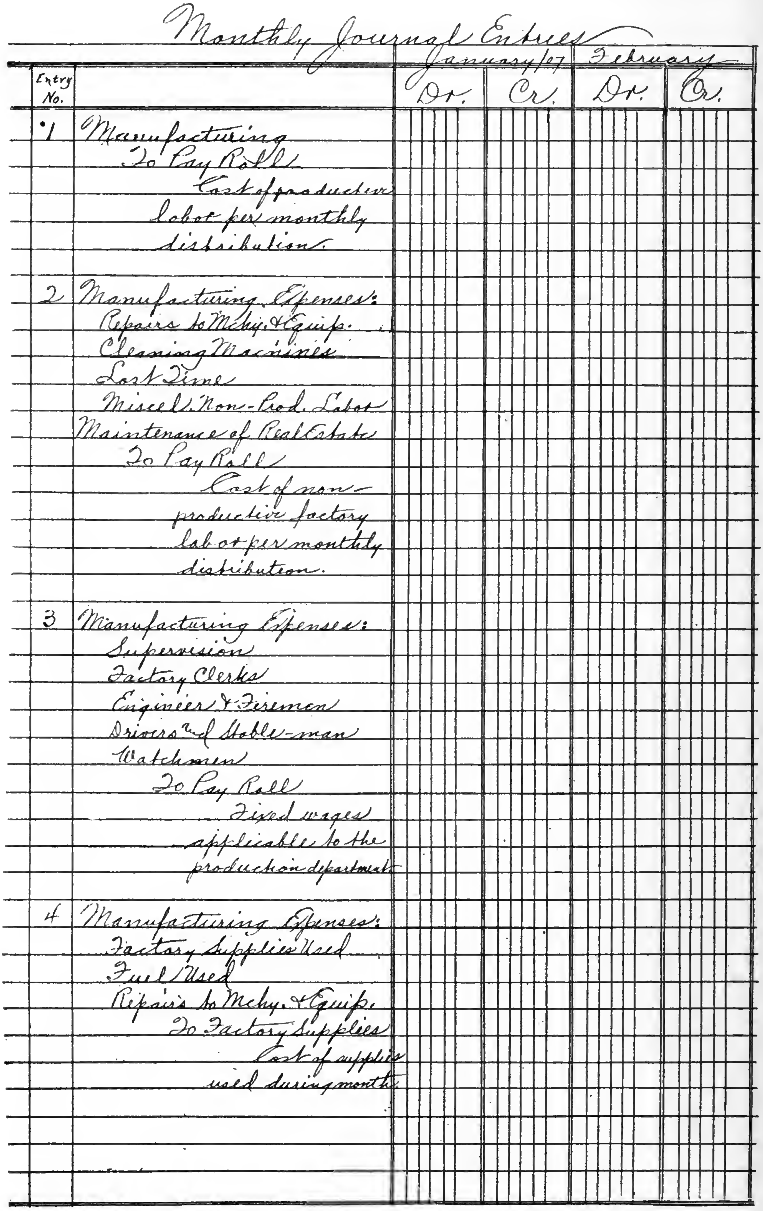
MONTH OF December 1907

	Accounts Payable	Miscellaneous	Folio			12/26/07	Folio	Miscellaneous	Accounts Receivable	Notes Payable	
	275 60			John Doe							
					To Notes Payable					275 60	
						Note dated Dec.					
						18, 1907 for 60 days with					
						interest, in payment					
						of bill of same date.					
						12/31/07					
		9000 –		Surplus							
					To Dividend Acct.			9000 –			
						To transfer to Dividend					
						account an amount					
						equal to six percentum					
						of the capital stock					
						outstanding ($150,000.00)					
						as provided for in the					
						minutes of Board					
						of Directors dated Dec.					
						9, 1907. (For details see					
						Dividend Book.)					

In most businesses there are certain journal entries which must be made monthly. To curtail clerical work and dispense with the possibilities of omissions, it is advisable to have inserted in the back of the regular journal a quire of twelve-column paper, such as may be found in the old-fashion trial balance books. All monthly journal entries should be outlined as illustrated in Cut No. 18, and twelve double columns should be headed according to the months of the year. It is only necessary to insert the proper amounts each month and check them off as they are posted.

The entries shown in Cut. No. 18 are those referred to in the preceding chapters dealing with manufacturing cost records.

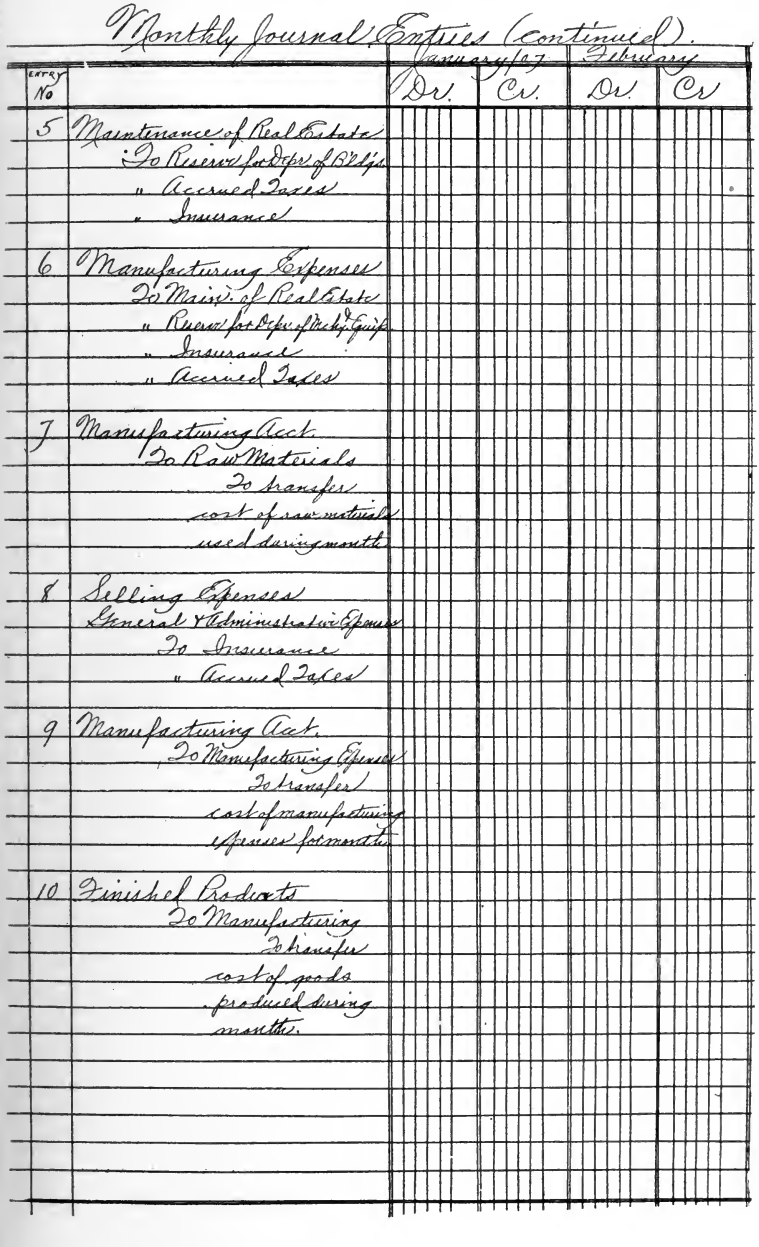
Cut No. 18. Monthly Journal Entries and Part of



Monthly Journal Entries

Entry No.		January/07		February	
		Dr.	Cr.	Dr.	Cr.
1	Manufacturing				
	To Pay Roll				
	Cost of productive				
	labor per monthly				
	distribution.				
2	Manufacturing Expenses:				
	Repairs to Mchy. & Equip.				
	Cleaning Machines				
	Lost Time				
	Miscell. Non-Prod. Labor				
	Maintenance of Real Estate				
	To Pay Roll				
	Cost of non-				
	productive factory				
	labor per monthly				
	distribution.				
3	Manufacturing Expenses:				
	Supervision				
	Factory Clerks				
	Engineer & Fireman				
	Drivers and Stable-man				
	Watchmen				
	To Pay Roll				
	Fixed wages				
	applicable to the				
	production department				
4	Manufacturing Expenses:				
	Factory Supplies Used				
	Fuel Used				
	Repairs to Mchy. & Equip.				
	To Factory Supplies				
	Cost of supplies				
	used during month.				

Twelve-Column Sheet of Stock Paper.



Monthly Journal Entries (continued).

		January/07		February	
Entry No		Dr.	Cr.	Dr.	Cr.
5	Maintenance of Real Estate				
	To Reserve for Depr. of Bldgs.				
	" Accrued Taxes				
	" Insurance				
6	Manufacturing Expenses				
	To Maint. of Real Estate				
	" Reserve for Depr. of Mchy. Equip.				
	" Insurance				
	" Accrued Taxes				
7	Manufacturing Acct.				
	To Raw Materials				
	To transfer				
	cost of raw materials				
	used during month				
8	Selling Expenses				
	General & Administrative Expenses				
	To Insurance				
	" Accrued Taxes				
9	Manufacturing Acct.				
	To Manufacturing Expenses				
	To transfer				
	cost of manufacturing				
	expenses for month				
10	Finished Products				
	To Manufacturing				
	To transfer				
	cost of goods				
	produced during				
	month.				

§ 124. The Stock Ledger.

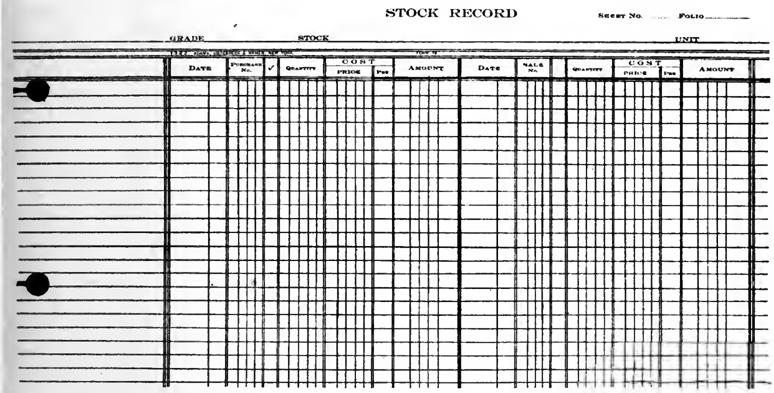
Modern business management requires a monthly statement showing the condition of the business and the results from its operation. A complete and true statement of this kind cannot be compiled unless a perpetual inventory is kept or unless an actual inventory is taken monthly.

A physical inventory involves a large amount of work, is very difficult to take, and is seldom correct. When an inventory is to be made, it is too often delegated to employees who do not appreciate the great importance of doing the work carefully and correctly; insufficient time is allowed them for performing the work as it should be done, and the result is that errors are made and are not discovered. Obviously the profits are affected to the extent of such errors, and a balance sheet based upon such inventories, does not reflect the true condition of affairs.

The larger part of this work and of this liability to error, can be avoided by the use of the perpetual book inventory. This should show the quantity and cost of each commodity on hand at the close of the month. The stock ledger provides this perpetual book inventory in convenient form, showing the raw materials, factory supplies and finished products in the case of manufacturing establishments, and the merchandise on hand in the case of mercantile establishments. When it is kept, a physical inventory is made at least annually, at which time any differences between the book figures and the figures of the physical inventory are investigated and adjusted.

An excellent form of stock ledger is illustrated in Cut No. 19. It is advisable to use a loose-leaf book for this purpose, provided there are over one hundred stock accounts. The form illustrated was designed for a lumber business but may be easily modified to meet the requirements of any other business.

Cut No. 19. Stock Ledger Sheet.
(Size of Original, 10¾ x 11 inches.)



STOCK RECORD Sheet No. ..... Folio ....

GRADE STOCK UNIT

				COST							COST		
DATE	PURCHASE No.	✓	QUANTITY	PRICE	PER	AMOUNT	DATE	SALE No.		QUANTITY	PRICE	PER	AMOUNT

The manner of keeping the stock ledger will be treated with respect to,—(a) mercantile establishments and (b) manufacturing establishments.

§ 125. (a) Stock Ledger for Mercantile Establishments.

All purchase invoices should be delivered to the stock ledger clerk after they are approved and after the goods have been received. A stock account should be kept with each kind or class of commodity dealt in. The items shown on each purchase invoice should be recorded on the debit side of the proper stock accounts in the order illustrated by Cut No. 19. The price-per-unit (pound, piece, ton, foot, etc.) should be carried to at least four places.

If the cost prices of goods sold are to be recorded on each duplicate bill, it will be necessary for the stock ledger clerk to enter each sale on the credit side of the proper stock accounts, at which time he should compute the cost of each item and record it in the "cost" column of the stock account and also on the duplicate bill. This plan contemplates the showing of profits on the duplicate of all bills rendered,[1] but in some businesses this is not found practical. It then becomes necessary to resort to the method of entering at the end of every month the total quantity of each commodity sold during that month.

In computing the cost of commodities sold, it is important that the price-per-unit of the first lot purchased be used until that lot is entirely exhausted; the price-per-unit of the second lot should then be used, etc. This leaves the goods on hand at most recent prices and enables the clerk to know what cost prices to use. When a lot is exhausted it is well to check it off against the items on the credit side which are used to exhaust it. This may be done by placing a different letter of the alphabet opposite each purchase and the same letter opposite the corresponding credits (sales). These check marks should be placed in the check mark column.

All goods returned by customers and placed back in stock should be entered on the debit side of the proper stock accounts at their original cost prices. This necessitates book entries reversing the profits originally made on the sales.

From the foregoing it will be seen that all purchases and returns are recorded at cost on the debit side of the proper stock accounts and that all sales are recorded at cost on the credit side of the proper stock accounts. It follows, therefore, that the difference between the total debit quantities and amounts and the total credit quantities and amounts of any particular stock account should represent the quantity and cost of that commodity on hand.

All goods purchased should be charged and all goods sold should be credited (at cost) to "Purchases" account in the general ledger. The balance of that account should represent the cost of goods on hand and agree with the sum total of all balances shown by the stock accounts. A trial balance should

[1] See § 103.

be compiled from the stock ledger monthly. The difference between the debit and credit sides of this balance should, of course, agree with the balance of the " Purchases " account as shown by the general ledger.

§ 126. (b) Stock Ledger for Manufacturing Establishments.

In manufacturing establishments it is necessary to keep three classes of stock accounts,—(1) " Raw Materials," (2) " Factory Supplies," and (3) " Finished Products." Different colored stock ledger sheets may be used to designate the three classes of accounts; white for raw materials, pink for factory supplies, and buff for finished products.

The cost of all raw materials and factory supplies purchased should be recorded on the debit side of the proper stock accounts, direct from the invoices after they have been approved and after the goods are received. In computing the price-per-unit, freight inward should be added to the invoice cost of commodities purchased.

The cost of all raw materials and factory supplies used should be recorded on the credit side of the proper stock accounts, direct from the requisitions, engineer's report of fuel used, etc.

The quantities of goods produced should be recorded on the debit side of the proper finished product accounts from the factory production reports. The price-per-unit and cost should be inserted as soon as monthly costs have been computed. If goods are exclusively manufactured on special orders, no stock accounts with finished products will be necessary as they are billed when completed.

Sales should be handled according to the method explained in § 125.

Trial balances compiled from the three classes of accounts in the stock ledger should agree with the balances of the

"Raw Materials," "Factory Supplies," and "Finished Products" accounts in the general ledger.

§ 127. Classification of Expenses.

In mercantile establishments there are usually two classes of expenses; viz., "Selling Expenses" and "General and Administrative Expenses." In manufacturing establishments there is a third class known as "Manufacturing Expenses." In the case of retail establishments the selling expenses are usually classified according to the departments.

The following classifications serve to illustrate how these three classes of expenses are usually divided.

(1) *Manufacturing Expenses.* (a) Net Maintenance of Real Estate, or Rent of Factory. (b) Power, Heat and Light. (c) Depreciation of Machinery and Equipment. (d) Repairs to Machinery and Equipment. (e) Insurance on Machinery, Raw Materials, etc. (f) Taxes on Machinery, Raw Materials, etc. (g) Factory Supplies Used. (h) Stable Expenses. (i) Non-Productive Labor:—Superintendent, Foremen, Engine-room Labor, Receiving Dept. Labor, Watchman, Factory Clerks, Cleaning Machines., etc., Lost Time, Miscellaneous.

(2) *Selling Expenses.* (a) Salesmen's Salaries. (b) Agents' Commissions. (c) Salesmen's Expenses. (d) Credit-Man's Salary. (e) Mercantile References. (f) Advertising:—Magazines and Newspapers, Bill-boards and Street Cars, Circularizing and Postage, Miscellaneous. (g) Shipping Department Expenses:—Wages, Supplies. (h) Freight Outward. (i) Insurance on Finished Goods. (j) Taxes on Finished Goods. (k) Samples, Cases, etc. (l) Branch Office Expenses. (m) Miscellaneous.

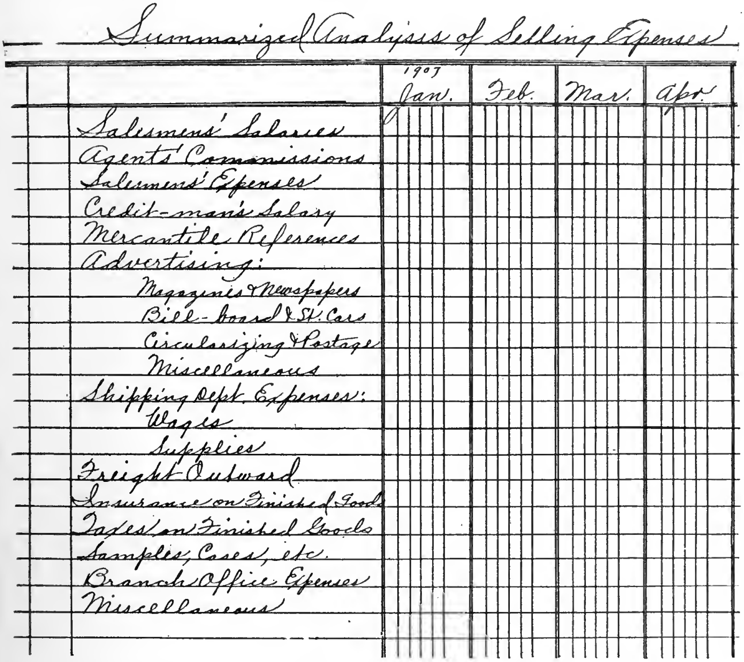
(3) *General and Administrative Expenses.* (a) Officers' Salaries. (b) Officers' Expenses. (c) Office Help. (d) Office Supplies. (e) General Postage. (f) Telephone and

Telegrams. (g) Corporation Taxes. (h) Legal Expenses. (i) Directors' Fees. (j) Miscellaneous.

§ 128. The Analysis Book.

An account should be kept in the general ledger headed "Manufacturing Expenses," and all indirect expenses applicable to the production department (the factory) should be charged to it. A second account should be headed "Selling Expenses" and all expenses applicable to the selling department should be charged therein. A third account should be headed "General and Administrative Expenses" and all expenses applicable to the administrative department, or that are

Cut No. 20. Portion of Sheet from Analysis Book. (Size of Original Sheet with Twelve Columns, 17 x 13½ inches.)



Summarized Analysis of Selling Expenses

		1907 Jan.	Feb.	Mar.	Apr.
	Salesmens' Salaries				
	Agents' Commissions				
	Salesmens' Expenses				
	Credit-man's Salary				
	Mercantile References				
	Advertising:				
	Magazines & Newspapers				
	Bill-board & St. Cars				
	Circularizing & Postage				
	Miscellaneous				
	Shipping Dept. Expenses:				
	Wages				
	Supplies				
	Freight Outward				
	Insurance on Finished Goods				
	Taxes on Finished Goods				
	Samples, Cases, etc.				
	Branch Office Expenses				
	Miscellaneous				

general to the business, should be charged to that account. The distribution of expenses to these three controlling accounts should be in accordance with the classification given in § 127.

In addition to this, an analysis of the expenses chargeable to these three accounts should be made at the close of each month, for entry in the analysis book. This analysis should be according to the classifications of § 127 and should be made in the first place on sheets of paper, each separate charge being picked out from the different books of original entry. The analyses should then be summarized in the analysis book under the proper month. Cut No. 20 illustrates a partial sheet of an analysis book and the proper arrangement for the classification of selling expenses. A twelve-column book may be secured from dealers in blank books, and serves the purpose of an analysis book very well. Several pages should be allotted to each of the expense accounts. The footings of the three accounts should agree with the total charges for the corresponding month to the three controlling accounts in the general ledger.

§ 129. Advantages of Analysis Book.

When the analysis book is used, but one controlling account in the general ledger is necessary for recording the expenses of an entire department. Without the analysis book about twelve accounts would have to be kept in the general ledger in order to show a complete analysis of selling expenses alone, or about fifty accounts in order to properly classify the expenses of the manufacturing, selling and administrative departments. Thus by the use of the analysis book the volume of postings to the general ledger is greatly reduced, and the work of compiling monthly trial balances is materially decreased.

The analysis book also provides a comparative analysis of the expenses of each department, month by month, in tabular form, thus enabling one to compare at a glance the respective expenses of the different months, any material fluctuations being readily noted.

§ 130. The General Ledger.

The general or private ledger is the final resting place of all bookkeeping results from business transactions. It is where the classified results of the business in dollars and cents are assembled. It should be a bound book with regular ledger rulings. For this ledger there are absolutely no advantages to be gained from using a loose-leaf book as there should be no "deadwood" in a general ledger, and the loose-leaf is much more cumbersome and difficult to finger in turning the leaves.

Accounts in the general ledger should be arranged according to the classification given in Chap. XVI of the present volume. They should not be ruled off and balances brought down more often than semi-annually. Transfers from one account to another should be effected by means of transfer entries in the journal and not by cross entries. All profit and loss accounts should be closed into the "Profit and Loss" account semi-annually by means of journal entries.

It is very important that careful attention be given to posting details, such as accuracy in recording the date, folio and amount. Also brief particulars of items posted should be brought in so as to explain their meaning to any one who may have occasion later to refer to the ledger.

§ 131. Subsidiary Ledgers.

These are sometimes known as "Side" ledgers, "Auxiliary" ledgers, etc. The customers' ledger, creditors' ledger, stockholders' ledger, cost ledger, stock ledger and securities ledger, are all subsidiary ledgers. The analysis book is also a subsidiary record and bears the same relation to the corresponding controlling expense accounts in the general ledger as the above-named ledgers bear to the "Accounts Receivable," "Accounts Payable," "Capital Stock," "Manufacturing," "Purchases," and "Securities Owned" accounts in the general ledger. They are subsidiary to those accounts and support them with details.

§ 132. Controlling and Subsidiary Accounts.

Any account appearing in the general ledger is termed a "controlling" account if it is supported or presented in more complete or detailed form in some subsidiary account or book. Any record which supports in detail a controlling account in the general ledger, is a subsidiary record.

Taking a wholesale grocery establishment as an illustration, the accounts of customers may require five ledgers of 500 pages each. These are subsidiary records. "Accounts Receivable" account in the general ledger is the corresponding controlling account. During the month each separate sale is posted to the debit of the proper customer's account in the subsidiary ledger. At the month's end the total sales for the month are posted to the debit of the controlling account in the general ledger. All cash received and all returns and allowances during the month are separately credited to the proper customers' accounts. At the close of the month the total cash received from customers and the total returns and allowances are credited to the controlling account in the general ledger. Obviously, the aggregate of all customers' balances should exactly equal the balance of the controlling account and this controlling account alone appears in the general trial balance.

Without a controlling account it would be necessary in compiling the trial balance to bring in all the balances of the customers' ledgers. If, then, the trial balance were "out," it would be impossible to tell whether the error was in the general ledger or in the customers' ledgers, and the trouble involved in finding the error would be enormously increased.

With a controlling account the trial balance is compiled without reference to the customers' ledgers, the balance of the controlling account representing the balance of all accounts of the customers' ledgers.

§ 133. Relations between Controlling and Subsidiary Accounts.

It is not difficult to understand a controlling account or the relations between it and the subsidiary record which supports it, if one will bear in mind the fact that every item charged in the subsidiary record must also eventually be charged to the controlling account and that every credit in the subsidiary record must also eventually be credited to the controlling account in the general ledger. Of course both credits and debits to the controlling account may be and usually are effected in monthly totals rather than singly as in the case of the subsidiary records, but the results are the same. It will thus be seen that the debits and credits of both the controlling account and its subsidiary record are equal, and that the latter is an analysis or a classified record of the former. It follows, therefore, that a trial balance compiled from the subsidiary ledger should exactly agree with the balance of the controlling account. It will be understood, of course, that the two sides of a subsidiary ledger trial balance are not necessarily equal in amount. The difference between the two sides should, however, always equal the balance of the corresponding controlling account of the general ledger.

Trial balances should be compiled from subsidiary ledgers after the general ledger trial balance has been correctly compiled. If, then, there is a difference between the subsidiary trial balance and the controlling account, it may be taken for granted that, in the great majority of cases, it will be located in the former.

§ 134. The Trial Balance Book.

Trial balances should be compiled from the general ledger at the close of each month. The balances of open accounts should be used rather than the footings.

Much labor is saved in the preparation of the general trial balance by the use of a trial balance book. These books are arranged so as to avoid rewriting the headings of accounts each time a trial balance is taken. In the usual form the first sheet extends beyond the margin of the following sheets. The headings of the accounts are written on this extension of the first sheet, and, overlapping as it does the following sheets, the accounts once written do not have to be recopied until a new book is opened.

The treasurer's or accountant's monthly report should be made up from the trial balance of the general ledger. The form and arrangement of this report will depend somewhat upon the nature of the business and the scope of detail required by the management. Exhibit " A " and Exhibit "B" of the audit report shown in Chap. XIX of the present volume, give respectively the form and arrangement of a balance sheet and of a profit and loss statement.

CHAPTER XVI.

LEDGER ACCOUNTS,—THEIR FUNCTIONS AND ENTRIES.

§ 135. General.

In the present chapter an effort has been made to illustrate the functions of the more important of the general ledger accounts commonly found in manufacturing or mercantile establishments. To this end the proper debits and credits of each account are given; also what is shown, or what should be shown, by the difference between the debit and credit columns, i. e. the balance of the account.

(1) CLASSIFICATION.

§ 136. Arrangement of Accounts.

Accounts should be arranged in the following order,—(1) fixed assets; (2) floating assets; (3) fixed liabilities; (4) floating liabilities; (5) surplus account; (6) profit and loss account—followed by the profit and loss accounts; (7) statistical accounts. Care should be exercised in allotting sufficient space to each account—never less than a full page. It is well to have the accounts indexed alphabetically on a typewritten sheet and paste the sheet on a piece of card-board of the same size. The bookkeeper can stand this index in front of him when posting and thus avoid the use of the cumbersome index usually found in the front of general ledgers.

§ 137. Classification of Accounts.

The following classification of general ledger accounts illustrates the order in which they should appear in the general ledger.

(1) *Fixed Assets.*

(a) Land. (b) Buildings. (c) Machinery and Equipment. (d) Small Tools. (e) Patterns. (f) Stable Equipment. (g) Office Equipment. (h) Store Fixtures. (i) Goodwill. (j) Patent Rights. (k) Sinking Fund.

(2) *Floating or Current Assets.*

(a) Cash. (b) Imprest Fund. (c) Accounts Receivable. (d) Consignments. (e) Notes Receivable. (f) Finished Products (on hand). (g) Manufacturing (goods in process). (h) New Materials (on hand). (i) Factory Supplies (on hand). (j) Stable Supplies (on hand). (k) Insurance (unexpired premiums). (l) Treasury Stock. (m) Stock of Other Companies.

(3) *Fixed Liabilities.*

(a) Preferred Stock. (b) Common Stock. (c) Mortgages Payable. (d) Mortgage Bonds. (e) Accumulative Bonds.

(4) *Floating or Current Liabilities.*

(a) Notes Payable. (b) Accounts Payable. (c) Accrued Interest on Mortgages. (d) Accrued Interest on Bonds. (e) Accrued Taxes. (f) Pay Roll (accrued labor). (g) Agents' Accounts (unearned commissions). (h) Reserve for Depreciation.

(5) *Surplus.*

(6) *Profit and Loss Accounts.*

(a) Profit and Loss. (b) Sales. (c) Income from Rentals. (d) Income from Stocks of Other Companies. (e) Miscellaneous Income. (f) Selling Expenses. (g) General and Administrative Expenses. (h) Discounts. (i) Interest on Borrowed Working Capital.

(7) *Statistical Accounts.*

(a) Manufacturing Expenses. (b) Dividend Account. (c) Subscriptions. (d) Subscribed Stock. (e) Cash Sales.

(2) ASSET ACCOUNTS.

§ 138. Land.

Debit With:

(1) Acquisition cost of land purchased. (2) Cost of surveying, title insurance, recording fees, etc. (3) Cost of improvements; e. g., grading, constructing roads and walks, excavating and piping for sewers, water, gas, etc. (4) Cost of carrying charges until the land becomes productive or until buildings are erected thereon; e. g., interest on mortgage covering the land, taxes on the vacant land, etc.

Credit With:

(1) Cost of land sold. Profit or loss are not entered in this account but at the time land is sold "Profit and Loss" account is credited with profit, or charged with the loss, resulting from the sale.

Balance:

Represents the cost of land owned.

Note:

As this account is intended to show the cost of land owned, it is never advisable to carry land on the books in excess of its cost, even though it may have increased in value very materially.

§ 139. Buildings.

Debit With:

(1) Actual cost of buildings purchased or constructed. The construction costs may include architect's plans, commission for placing a building loan, cost of material, labor, team

service, supervision, interest on building loan until buildings are completed, etc. In fact all expenses incurred as a result of constructing buildings should be charged to this account. (2) Cost of replacing buildings, or important parts thereof, destroyed by fire, or by virtue of wear and tear and passage of time.

Credit With:

(1) Cost of buildings replaced, at which time "Reserve for Depreciation of Buildings" or, if no reserve is periodically set aside, "Maintenance of Real Estate" account should be charged.

Balance:

Represents the cost of buildings owned.

Note:

In charging the cost of labor, material, or team service used in constructing buildings, it is correct to use the exact costs and not inflated costs; e. g., a lumber company should charge the lumber used at what it actually costs them and not at their selling prices, as is sometimes done, on the ground that the cost to any one not in the lumber business would be based on retail prices. Likewise some railroad companies charge to their construction accounts the full rates for hauling their own materials. This results in increasing their apparent profits by doing work for themselves. Real profits are not made in this manner, and the principle is radically wrong.

It is advisable to allot a number to each building, and keep the construction costs of each separate. An analysis book (See § 140) should be used for this purpose and should show the complete cost of each building. When a building or an important part thereof is replaced, the cost of the old one should be taken out of its account and the cost of the new one taken in.

When a periodical reserve (say monthly) is set aside to provide for depreciation of building, the estimated life of the buildings is the controlling factor in deciding upon the rate of reserve. If the average life is estimated at twenty-five years, four per centum of the cost should be set aside yearly, or one-twelfth of four per centum monthly. This estimate contemplates that the buildings will be kept in repair; the reserve is to meet the cost of replacements and not of repairs. Consequently when a building is replaced, the cost of it should be charged against the reserve. A clear understanding of the difference between a repair and a replacement is therefore most essential.

A replacement is either the re-erection of an entire building or the reconstruction of some specific and material portion of it. Anything less than this, designed to maintain the appearance or utilities of a building, is to be classed as a repair. Thus putting on a new roof is a replacement; putting in a new door is a repair.

Replacements are charged to "Buildings" account, at which time the actual or estimated cost of the building or portion thereof replaced, should be charged against the reserve, or, in case no reserve is provided, against the income. Repairs should never be charged to "Buildings" account but rather to "Maintenance of Real Estate," or to "Income from Rentals" in the case of rental properties.

As the words repair and replacement have so similar a meaning, it is advisable to mentally substitute the word maintenance for repair when attempting to decide whether an item is to be charged to building account or against income.

The cost of additions to buildings should be charged to "Buildings" account, inasmuch as the outlay increases the value of the assets. Alterations should be charged to "Buildings" account only when they increase the original efficiency or value of the building altered; otherwise they should be charged against the income. In case of doubt, it is advisable to charge an item against the income rather than to "Buildings" account. In other words, before charging the latter account, always be sure that the value of assets is actually increased to the extent of the contemplated charges.

§ 140. Machinery and Equipment.

Debit With:

(1) Cost of boilers, engines, dynamos, motors, stationary machines and scales, elevators, hangers, pulleys, inside piping for heat and power, etc. (2) Cost of setting up boilers, engines, machines, scales, elevators, etc., but not with cost of shifting them about. (3) Cost of additions or alterations to any articles charged to this account, provided their original efficiency is increased thereby accordingly. (4) Cost of replacing any article charged to this account.

Credit With:

(1) Cost of any article sold, at which time the difference between the cost and amount realized from sale should be charged against the "Reserve for Depreciation of Machinery and Equipment" account, or "Manufacturing Expenses" account if no provisions are made for depreciation. (2) Cost of any article or part replaced or discarded, at which time "Reserve for Depreciation of Machinery and Equipment" account should be charged, or "Manufacturing Expenses" if no reserve is periodically set aside.

Balance:

Represents the cost of stationary machinery and equipment on hand.

Note:

An analysis book was suggested in the preceding section for the purpose of keeping a detailed record of construction costs of buildings. Other portions of the same book may be used for keeping a going inventory of the stationary machinery and equipment, small tools, patterns, stable equipment, office equipment, etc. This makes it a perpetual inventory of all tangible fixed assets.

A book of four hundred pages, regular journal rulings, answers every purpose of such an analysis book. The different sections of the book may be designated by tabs attached to the first page of each section. The left page should be used for recording the articles purchased in the following order,—(1) date purchased; (2) from whom purchased; (3) article; (4) folio, and (5) cost. The right page should be used for recording the articles sold or otherwise disposed of in the following order,—(1) date; (2) how disposed of (sold, discarded, destroyed, etc.); (3) folio, and (4) cost. The balance of the section devoted to machinery and equipment should agree with the balance of the " Machinery and Equipment " account in the general ledger.

Such a record is almost indispensable to good bookkeeping. It affords an index to the cost of any machine, small tool, wagon, office desk, etc., etc., and enables the management to see just what is represented by the controlling ledger accounts.

Many manufacturing companies carry one account in the ledger headed " Plant." It frequently covers a " multitude of sins," and usually represents a complex mass of charges, some correct and some incorrect. Oftentimes it includes good-will, patent rights, services rendered, etc. The part that is " water " is never mentioned but it is often there nevertheless. A going inventory book in such a case would not be a coveted thing, but its importance is thereby none the less emphasized.

§ 141. Small Tools.

Debit With:

(1) Cost of all tools (this does not mean such utensils as brooms, mops, baskets, and such things as have only a short life, which should be classed as factory supplies), movable scales, trucks, belting, movable implements used about the factory, time recording devices, etc. (2) Cost of replacing any article previously charged to this account.

Credit With:

(1) Cost of any article replaced or discarded, at which time "Reserve for Depreciation of Small Tools" account should be charged, or "Manufacturing Expenses" if no reserve is periodically set aside. If articles discarded are afterwards sold, credit "Miscellaneous Income" or "Profit and Loss" account with the amount realized from the sales.

Balance:

Represents the cost of small tools, implements, etc., on hand.

§ 142. Patterns.

Debit With:

(1) Cost of stock patterns. If a pattern is made for some specific job, the cost of that pattern should be charged to the job, even though it may be used for other jobs. If stock patterns are made in the factory, each one should be given a number and the cost of producing them should be arrived at according to the "Production Order" method.[1]

Credit With:

(1) Cost of stock patterns which have become worthless by reason of wear and tear, defects, or passage of time. It is to be noted that a pattern is of no value, except for junk, after it permanently ceases to be used for a pattern.

Balance:

Represents the cost of usable patterns on hand which are being, or will be, used.

Note:

It is very important that a perpetual inventory of patterns be kept. Whenever the books are closed, it is advisable to have the book inventory compared with the patterns actually on hand, at which time all patterns that are worthless for use as such should be written off at cost, and charged to "Manufacturing Expenses" account. Of course this plan prevents the

[1] See Chap. XIV.

monthly costs from being affected by cost of patterns written off, and places the total charge against the last month of each closing period. It is assumed, however, that a statement of production costs will be compiled at the end of each closing period by means of combining the monthly statements. It is not advisable in most cases to adjust the " Patterns " account each month.

§ 143. Stable Equipment.

Debit With:

(1) Cost of horses, wagons, harnesses, hay-cutters, etc., purchased. (The cost of shovels, forks, pails, halters, blankets, brushes, surcingles, etc., have too short a life to be capitalized, and should be charged to " Stable Expenses " account when purchased). (2) Cost of replacing horses, wagons, etc., previously charged to this account.

Credit With:

(1) Cost of horses, wagons, etc., sold. The difference between the cost and selling price should be charged or credited to " Stable Expenses " account, provided no reserve for depreciation is set aside periodically. (2) Cost of horses which have died, and with cost of horses, wagons, etc., replaced or discarded, at which time " Stable Expenses " account should be charged, unless a reserve is set aside for depreciation of stable equipment.

Balance:

Represents the cost of stable equipment on hand.

Note:

Where the stable equipment is small, consisting of five or six horses, three or four wagons and the necessary accessories, it is not advisable to provide a reserve for depreciation of stable equipment. The amount to be charged off by reason of replacements, etc., at any one time will not be large enough to affect the profits materially.

It is essential that a perpetual book inventory be kept of stable equipment in order to afford an index to cost prices of all equipment purchased.

§ 144. Office Equipment.

Debit With:

(1) Cost of safes, desks, chairs, movable partitions, rugs, filing cases, letter presses, mimeographs, etc., purchased. (The cost of ink wells, waste baskets, etc., should be charged to "Office Supplies" account as their life is too short to be capitalized.) (2) Cost of replacing articles formerly charged to this account.

Credit With:

(1) Cost of articles replaced, discarded or destroyed, at which time "General and Administrative Expenses" should be charged, unless a reserve for depreciation of office equipment is periodically set aside.

Balance:

Represents the cost of office equipment on hand.

§ 145. Store Fixtures.

Debit With:

(1) Cost of movable partitions, counters, show cases, stools, chairs, cash registers and mechanical devices for carrying cash and parcels, shelving, trucks, etc. (2) Cost of replacing any article previously charged to this account.

Credit With:

(1) Cost of articles replaced, discarded or destroyed, at which time "Selling Expenses," or the proper departmental expense account should be charged.

Balance:

Represents the cost of store fixtures on hand.

Note:

The cost of interior alterations at the time of equipping a store, preparatory to beginning business, is a legitimate capital outlay, and should be charged to an asset account headed "Interior Alterations." The cost of such alterations should be written off over the period of time covered by the lease; i. e., if the lease is for ten years, it is advisable to write off ten per cent. per annum even though the lease provides for an option of renewal. Future alterations are not apt to be extensive and should be charged against the income.

In cases where the cost of store fixtures is large, say several thousands of dollars, it is advisable to set aside a monthly reserve for depreciation; otherwise it is not necessary, provided the cost of all replacements are charged against the income.

§ 146. Good-Will.

Debit With:

(1) Cost of good-will acquired.

Note:

Good-will represents the benefit or advantage which attaches to a particular business, in addition to the actual value of the property used to carry on such business, by reason of the public patronage resulting from the location of the business, the reputation or skill of the proprietor or management, the reputation of the goods sold, etc. It may also include the title to trade-marks, copyrights, etc., and the name of the business taken over, carrying all privileges enjoyed from their use by the former owner.

Good-will often represents the difference between the actual value of tangible assets and the cost of the business taken over.

In some cases "Good-Will" account is charged with a fictitious debit. Thus a corporation is formed to take over a business. While the owners are perhaps to receive but $50,000 in capital stock for the business, by agreement among the parties the price is placed at perhaps twice this amount and the directors authorize 1,000 shares of capital stock at the par value of $100 each to be issued to the owners in payment therefor. The owners then donate one-half of this stock to the company to be used as treasury stock. These shares having been issued for value, are supposedly full paid and may thereafter be sold at less than par without involving the purchasers in liability, which was the end to be attained by the fictitious price.[2]

Obviously the extra 500 shares must, when issued to the owners, be credited at par to the " Capital Stock " account and as there must be a corresponding charge, the " Good-Will " account is usually employed as a receptacle for the "water"—amounting to $50,000. Sometimes the " water " is concealed in some fixed asset account.

Good-will is a perfectly good asset when carried on the books at its actual cost, and it is not customary to write it off periodically. If, however, the corporate officials authorize part or all of it written off, " Surplus " account should be charged and " Good-Will " credited.

§ 147. Patent Rights.

Debit With:

(1) Cost of patent rights acquired. This cost should include all moneys disbursed for models, legal fees, consulting engineer's services, drawings, and in fact all items of expense incurred as a result of acquiring the patent.

Credit With:

(1) A monthly proportion of the cost of patents based on the time which the patents have to run. The age of a patent is seventeen years and consequently one-seventeenth of the cost should be written off annually, or one-twelfth of that rate

[2] See Chap. XXX.

monthly. If a patent is acquired after it has been running for, say, nine years, then one-eighth should be written off annually, "Manufacturing Expenses" account being charged.

Balance:

Represents the unexpired or deferred cost of patents in force.

§ 148. Sinking Fund.

Debit With:

(1) Moneys set aside for the specific purpose of meeting fixed obligations at a particular time. (2) Earnings derived from the investment of moneys charged to this account.

Credit With:

(1) Moneys disbursed for the purpose for which the fund was created.

Balance:

Represents the accumulated value of the fund set aside.

Note:

The difference between a sinking fund and a reserve fund is, that in creating the former, moneys are actually transferred from the regular working funds or capital and placed to the credit of a special interest-bearing bank account or invested in securities; in creating the latter, earnings, or anticipated earnings, are set aside periodically but are not actually withdrawn and the working capital is not therefore affected.

A sinking fund is usually created by investing moneys from time to time in securities, or an interest-bearing bank account, in such amounts and at such times as will accumulate to the amount of the fixed obligation to be retired at its maturity.

Some bond issues provide that a sinking fund must be created and that each year a proportionate amount shall be set aside in the custody of a trustee. This provision is made in order to insure prompt payment of the bonds at their maturity. Even though no such provision is made, it is advisable to set aside annually a certain amount so that when the obligation becomes due, there will be sufficient available funds to meet it, especially if the obligation is to be paid out of the income.

§ 149. Cash.

Debit With:

(1) Total amount of cash received during the month. (Entry made at close of month.)

Credit With:

(1) Total amount of checks issued during the month. (Entry made at close of month.)

Balance:

Represents the available balance in banks at the close of a month.

§ 150. Imprest Cash Fund.

Debit With:

(1) Amount of fund created to meet currency disbursements. (2) If the fund is to be increased, with amount of increase.

Credit With:

(1) If the fund be decreased, credit this account with the amount by which it is diminished.

Balance:

Represents the amount of the fund which is set aside to meet currency disbursements.

§ 151. Accounts Receivable.

Debit With:

(1) Total charge sales at close of each month. (2) Freight prepaid for account of customers.

Credit With:

(1) Footing of the "Accounts Receivable" column per cash receipts book at close of each month. This amount includes all moneys received from customers to apply on account plus the discounts allowed. (2) Allowances to customers for goods returned, claims allowed, etc. (3) Accounts that are uncollectable.

Balance:

Represents the amount due and collectable from customers, and should agree with the results of a trial balance compiled from the customers' ledgers.

§ 152. Consignments.

Debit With:

(1) Cost of goods consigned; i. e., goods shipped and stored at the owner's risk, to be paid for only in case they are sold.

Credit With:

(1) Cost of goods sold by consignee as per report. It is customary for consignees to render periodical reports showing sales made, goods on hand, expenditures chargeable to consignor, etc., at which time a settlement is made for the goods sold.

Balance:

Represents the cost of goods held by consignees.

Note:

Theoretically, it would be correct to charge consignments account with moneys expended for freight, insurance, storage, etc., but these charges would complicate the work of keeping a perpetual inventory of goods consigned, inasmuch as the price-per-unit would have to be changed when such charges were made, and it would be difficult to apportion them equitably. It is therefore advisable to charge such items direct to "Selling Expenses" account, and show in the analysis book these items as "Expenses of Consignments."

§ 153. Notes Receivable.

Debit With:

(1) Face value of notes of others received.

Credit With:

(1) Face value of notes of others paid, discounted or otherwise disposed of.

Balance:

Represents the face value of notes on hand.

§ 154. Purchases.

Debit With:

(1) Cost of all merchandise purchased. (2) Cost of freight inward on merchandise purchased. (3) Cost of goods returned by customers, unless the goods are damaged or imperfect in which case it is advisable to keep a special account for defective stock returned.

Credit With:

(1) Cost of merchandise sold or consigned, at which time "Sales" or "Consignments" account should be charged. (2) Cost of damaged or defective stock transferred to the defective stock account, or destroyed.

Balance:

Represents the cost of merchandise on hand.

Note:

It is assumed, in submitting the foregoing entries, that a perpetual book inventory is maintained. If such is not the case it will be impossible, of course, to accurately compute the cost of goods sold except when a physical inventory is made, and consequently the account could not be credited at the close of each month with the cost of sales. However, when a physical inventory is made, the cost of all goods sold from the date of last inventory should be computed and the total cost credited to "Purchases" and charged to "Sales." Since the balance of " Purchases " account before the credits are made represents the cost of goods on hand at the time the last inventory was taken plus the cost of goods bought since then, and the new inventory gives the cost of goods on hand, the difference between the new inventory and the balance of " Purchases " account must represent the cost of goods sold, which is to be credited to " Purchases " account.

In some businesses it is desirable to keep a separate purchase account for each department, or for certain classes of merchandise. This may be done by providing sufficient columns in the voucher register, or summary of purchases, depending upon the purchase system in use. Obviously, a corresponding classification of sales should be kept, thus necessitating a sufficient number of columns in the summary of sales book.

If the cost of freight inward is charged to "Purchases" account, it becomes necessary to add it to the invoice costs when computing the price-per-unit. It is difficult to apportion freight costs when a miscellaneous lot of goods are covered by one bill. If the adding of freight to invoice costs complicates computations of unit prices, it is well to omit that feature from the "Purchases" account entirely and charge all freight or goods purchased to a freight inward account.

§ 155. Finished Products.

Debit With:

(1) Production cost of all goods manufactured for stock. (2) Production cost of goods returned by customers. If defective or damaged stock is returned, it should be charged to an account kept for that purpose.

Credit With:

(1) Production cost of products sold, at which time " Sales " account should be charged. (2) Production cost of products consigned, at which time " Consignments " account

should be charged. (3) Production cost of damaged or defective products destroyed or transferred to defective stock account.

Balance:

Represents the cost of finished products on hand.

§ 156. Manufacturing.

Debit With:

(1) Cost of the three elements of production; viz., raw materials, labor, manufacturing expenses.

Credit With:

(1) Production cost of goods finished, at which time "Finished Products" account should be charged. (2) Production cost or partial cost of by-products, at which time "By-Products" account should be charged. (3) Production cost or estimated cost of "bad runs" (imperfect stock partially or wholly produced but unfit for the trade.)

Balance:

Represents the cost of goods in process of manufacture.

§ 157. By-Products.

Debit With:

(1) Cost of production labor devoted to the preparing of by-products for market. (2) The proper proportion of manufacturing expenses applicable to by-products, based on the cost of productive labor devoted thereto.

Credit With:

(1) With the cost of by-products sold.

Balance:

Represents the cost of such by-products on hand as have been prepared for market.

Note:

In many manufacturing businesses the by-products resulting from the manufacture of the regular products are sold and the amount realized from such sales during a year is often very considerable. If it is possible and practical to arrive at the cost or partial cost of by-products, it should be done. In that case a perpetual book inventory should be kept of them and the sales should be recorded in the "By-Products" account in order to arrive at the gross profit on such sales. In some cases, however, it is impossible to compute the cost of by-products. They are the inevitable result of manufacture and are often sold in their natural state, no labor being expended in preparing them for the market. In such cases they should not be carried on the books as an asset. The sales should be credited to a sales of by-products account and the balance of this account should be considered as a miscellaneous income when preparing a profit and loss statement.

§ 158. Raw Materials.

Debit With:

(1) Cost of all raw materials purchased. (This should include labels, crates, packing boxes, cartons, wrappings, etc., provided an accurate record can be kept of all such articles used.) (2) Cost of freight inward on raw materials purchased, provided it is practical to do so; otherwise "Freight Inward" account should be charged.

Credit With:

(1) Cost of raw materials used, at which time "Manufacturing" account should be charged. (2) Allowances made by creditors for goods damaged or returned.

Balance:

Represents the cost of raw materials on hand.

§ 159. Factory Supplies.

Debit With:

(1) Cost of all factory supplies purchased and put in charge of the stock clerk to be given out on requisitions; e. g., lubricating oils, waste, brooms, saws, hammers, shovels, repair

parts, plumbing supplies, steam fittings, paint, glass, sheet tin, etc. Articles that cannot be accurately accounted for as they are used, should be charged direct to "Manufacturing Expenses" account. (2) Cost of fuel purchased.

Credit With:

(1) Cost of all factory supplies used, as shown by stock clerk's report, or requisitions, as the case may be. (2) Cost of fuel used as shown by the engineer's monthly report. (3) Allowances by creditors for supplies damaged, returned, etc.

Balance:

Represents cost of factory supplies on hand.

Note:

It is never advisable to charge "Factory Supplies" account with the cost of anything which cannot be accurately accounted for as it is used. It is better to charge the cost of such things to "Manufacturing Expenses" account when they are purchased than to keep a perpetual book inventory incorrectly. If brooms are purchased in small quantities, say half-dozen lots, it is advisable to charge their cost to "Manufacturing Expenses" account. The same course should be pursued in the cost of lubricating oils, waste, etc., provided the stock clerk cannot keep accurate records of the quantities used.

It is necessary to exercise practical judgment when deciding upon matters pertaining to this feature of store-house commodities.

§ 160. Stable Supplies.

Debit With:

(1) Cost of hay, oats, straw, etc., purchased in large quantities.

Credit With:

(1) Cost of stable supplies used as shown by the barnman's monthly report, at which time "Manufacturing Expenses" account, or "Stable Expenses" account, should be charged.

Balance:

Represents the cost of stable supplies on hand.

Note:

If stable supplies are purchased in small quantities, sufficient to last a month or so, the above account should be eliminated from the general ledger.

§ 161. Insurance.

Debit With:

(1) Cost of insurance.

Credit With:

(1) The correct proportion of premiums charged to this account, credits being made at the close of each month.

Balance:

Represents the cost of insurance unexpired.

Note:

A record of each policy should be kept in a book provided for the purpose, showing the policy number, name of the company, date of policy, date of expiration, amount of insurance, total premium, property covered (buildings, machinery and equipment, raw materials and supplies, finished products, stable equipment, etc.), and monthly premium. The object of this record is to provide an index of all policies, the expiration date of each, and the proper monthly proportion of premiums which should be credited to " Insurance " account.

In the case of mutual insurance, it is necessary to estimate the cost of insurance according to past experience. An adjustment should be made when annual settlements are made by the mutual insurance companies.

§ 162. Treasury Stock.

Debit With:

(1) Cost of stock issued and subsequently purchased by the company. (2) With the market value of stock issued and subsequently donated to the treasury.

Credit With:

(1) Cost of treasury stock, which was formerly charged to this account, sold. If sold in excess of the amount at which it was carried, credit " Surplus " with the excess, and vice versa. (2) If treasury stock is retired, credit this account with the amount at which it was carried, charge or credit " Surplus " account with difference between that amount and the par value of the stock retired, and debit " Capital Stock " account with the par value.

Balance:

Represents the cost or actual value of treasury stock on hand.

Note:

Stock which has a real market value is very seldom donated to the treasury. Such donations usually represent stock which is to be sold for working capital at whatever it will bring. It is invariably sold below par and sometimes includes a generous amount of " water."

If stock donated to the treasury is of this nature or has no positive or ascertainable value at which it can be disposed of, a purely nominal entry should be made upon the books until it is sold, at which time " Surplus " account should be credited with any excess amounts realized. It is radically wrong to carry as an asset treasury stock at a fictitious or anticipated value. (See § 186.)

Charging " Treasury Stock " account and crediting " Surplus " account affords a very convenient and (to some persons) alluring way of creating a surplus, but the real value of such a surplus is strictly limited to the amount of money that can be realized from it. So long as the stock remains in the possession of the treasurer, it is nothing more than paper.

It must be borne in mind that unissued certificates are not treasury stock. In other words, if an authorized issue be $150,000 and the par value of stock issued be $100,000, then the difference of $50,000 represents absolutely nothing of value. It merely represents a privilege to issue additional stock at par to the extent of that amount.

§ 163. Stocks of Other Companies.

Debit With:

(1) Cost of stocks and bonds of other companies purchased.

Credit With:

(1) Cost of stocks and bonds of other companies disposed of. The difference between the cost and selling price should be charged or credited to "Profit and Loss" or "Miscellaneous Income" account.

Balance:

Represents the cost of stocks and bonds of other companies on hand.

(3) LIABILITY ACCOUNTS.

§ 164. Capital Stock.

(a) *Preferred Stock.*

Debit With:

(1) Par value of preferred shares retired.

Credit With:

(1) Par value of preferred shares issued.

Balance:

Represents the par value of shares outstanding.

(b) *Common Stock.*

Debit With:

(1) Par value of common shares retired.

Credit With:

(1) Par value of common shares issued.

Balance:

Represents the par value of common stock outstanding.

§ 165. Mortgages Payable.

Debit With:

(1) Payments on account of the principal of mortgages given.

Credit With:

(1) The principal sum of each mortgage given.

Balance:

Represents the amount owing on account of the principal of mortgages given.

§ 166. Bonds.

(a) *Mortgage.*

Debit With:

(1) The amount of mortgage bonds retired.

Credit With:

(1) The amount of mortgage bonds issued.

Balance:

Represents the amount of mortgage bonds outstanding.

(b) *Accumulative.*

Debit With:

(1) Moneys paid to retire accumulative bonds. (2) Payments forfeited by bondholders.

Credit With:

(1) Moneys received for account of accumulative bonds. (2) Semi-annual compound interest computed on the amount paid in on bonds.

Balance:

Represents the total amount of money received on account of accumulative bonds in force plus the accumulated interest on payments up to and including the last semi-annual interest date.

§ 167. Notes Payable.

Debit With:

(1) The face value of all notes redeemed.

Credit With:

(1) The face value of all notes issued.

Balance:

Represents the aggregate face value of notes outstanding.

Note:

A subsidiary record is kept for the purpose of showing the details of all notes of others received, and of all notes issued. Such a record, commonly termed a bill book, may be purchased from dealers in blank books. One part of the book is devoted to "Notes Receivable" and the other part to "Notes Payable."

§ 168. Accounts Payable.

Debit With:

(1) Footing of "Accounts Payable" column per cash book. (Entry made at close of each month.) (2) Amounts allowed by creditors for goods returned, damaged, etc.

Credit With:

(1) Footing of "Accounts Payable" column per voucher register or summary of purchases book, depending upon the purchase system in use. (Entry made at close of each month.)

Balance:

Represents the amount owing to creditors for goods received, and should exactly agree with the aggregate amount of unpaid vouchers if a voucher system is in use; otherwise with the results of a trial balance compiled from the creditors' ledger.

§ 169. Accrued Interest.

(a) *On Mortgages Payable.*

Debit With:

(1) Payments of interest on mortgages outstanding.

Credit With:

(1) Interest accrued on mortgages outstanding for the month. (Entry made at close of each month.)

Balance:

Represents the amount of interest accrued but not due.

(b) *On Bonds.*

Debit With:

(1) Payments of interest on bonds outstanding.

Credit With:

(1) Interest accrued for the month on bonds outstanding. (Entry made at close of each month.)

Balance:

Represents the amount of interest accrued but not due.

§ 170. Accrued Taxes.

Debit With:

(1) Amount of tax bills when they are paid, at which time the account should be adjusted through the "Profit and Loss" account.

Credit With:

(1) Estimated monthly proportion of taxes, at which time charge "Manufacturing Expenses," "Selling Expenses" and

"General and Administrative Expenses" accounts. (The estimate should be based on the amounts paid for taxes of the prior year.)

Balance:

Represents estimated taxes accrued but not due.

§ 171. Pay Roll.

Debit With:

(1) All moneys paid for factory labor, supervision, clerk hire, etc. (2) Amounts chargeable to workmen for rent of cottages, gas consumed, electric light service, etc.

Credit With:

(1) Total cost of productive labor. (2) Total cost of non-productive factory labor. (3) Total amount of fixed salaries and wages applicable to the factory. All these entries are made at close of each month.

Balance:

Represents wages accrued but not due.

§ 172. Agents' Accounts.

Debit With:

(1) Advances on account of commissions and expenses. (2) Payments to cover the balance of earned commissions at the time of making periodical settlements based on earnings.

Credit With:

(1) Commissions allowed on sales. (2) Expenses allowed.

Balance:

Represents the aggregate commissions which agents are entitled to as they are earned.

Note:

A subsidiary record should be kept for the purpose of providing a separate account with each agent. It should show the date and amount of each sale, to whom the sale was made, amount of commission on each sale, and how payable. If agents are entitled to draw commissions as they are earned, and if such earnings consist of a certain proportion of the moneys received on account of their sales, it will be necessary to keep an "Earnings" account with each agent in addition to the first mentioned account, which deals with gross commissions. Such an account should be credited monthly with the earned commissions and expenses allowed, and charged with the moneys advanced. The balance represents commissions due, or the amount by which the agent has overdrawn his earnings. The earnings account is merely for statistical purposes, and has no effect upon the general ledger account. The regular agent's account is credited with gross commissions, whether earned or not, and charged with all advances. The sum of the balances of these accounts should agree with the balance of the general ledger account.

§ 173. Reserve for Depreciation of Machinery and Equipment.

Debit With:

(1) Cost of replacing machinery and equipment or material parts thereof, at which time credit "Machinery and Equipment" account. (2) Difference between the cost and selling price of machinery sold, at which time the "Machinery and Equipment" account should be credited. (3) Cost of machinery and equipment discarded or destroyed, at which time "Machinery and Equipment" account should be credited.

Credit With:

(1) At the close of each month with one-twelfth of the amount produced from multiplying the balance of the "Machinery and Equipment" account by the annual rate of depreciation, at which time "Manufacturing Expenses" account should be charged.

Balance:

Represents the available reserve for depreciation. When a balance sheet is compiled, the balance of this account should be deducted from the cost of machinery and equipment in order to show the estimated present value to a going business.

Note:

A separate account should be kept with "Reserve for Buildings," "Reserve for Small Tools," "Reserve for Stable Equipment," etc., provided monthly reserves are set aside to meet the cost of replacements as they occur from time to time. Such accounts should be handled in the same manner as "Reserve for Depreciation of Machinery and Equipment."

The annual rate of depreciation is an estimate at best and differs widely according to conditions and opinions. The age of frame buildings for factory use is often estimated at twenty-five years thus necessitating an annual rate of reserve for depreciation of four per centum. The average age of machinery and equipment is often estimated at ten years; of stable equipment the same, and of small tools, five years.

If ten per centum per annum of machinery and equipment is reserved for depreciation, and a machine is replaced three years from the date purchased, it would be theoretically correct to charge the reserve account with only thirty per centum of its cost, as this is the amount reserve has been credited on account of that particular machine. This would necessitate charging "Surplus" with the remaining seventy per centum. It is not advisable to put this theory into effect, however, as some machines will last much longer than ten years while others must be replaced in much less time than ten years. It thus follows that such inconsistencies adjust themselves in the long run on a basis that is quite as equitable as if an elaborate method were operated with a view to securing more accurate results.

(4) SURPLUS, PROFIT AND LOSS, AND STATISTICAL ACCOUNTS.

§ 174. Surplus.

Debit With:

(1) Dividends declared by the board of directors, at which time credit " Dividend " account.

Credit With:

(1) Net profit as shown by the " Profit and Loss " account after the semi-annual closing entries are made and posted, at which time " Profit and Loss " account should be charged, thus causing this latter account to balance.

Balance:

Represents the accumulated net profits to and including the last closing period, less any dividends paid.

§ 175. Profit and Loss.

Debit With:

(1) Extraordinary items of expenses, extraneous losses, etc. (2) Balance of all expense accounts, and accounts showing losses, at each closing period, say semi-annually; e. g., " Selling Expenses," " General and Administrative Expenses," " Discounts," " Interest on Borrowed Capital," " Bad Accounts," etc.

Credit With:

(1) Items of income or extraneous profits which are not applicable to any of the regular accounts kept. (2) Balance of all accounts showing income or profits, at each closing period, say semi-annually; e. g., " Sales," " Income from Rentals," " Income from Investments," etc.

Balance:

After all closing entries are made and posted, the balance of this account represents the net profit for the period and should be transferred by journal entry to the credit of " Surplus " account.

§ 176. Sales.

Debit With:

(1) Total cost of goods sold. (Entry made at close of each month.) (2) Gross profits taken on goods sold and afterwards returned.

Credit With:

(1) Total cash and charge sales. (Entry made at close of each month.)

Balance:

Represents the gross profits on sales, and should be transferred semi-annually to the " Profit and Loss " account.

§ 177. Income.

(a) *From Rentals.*

Debit With:

(1) Cost of maintaining properties rented; e. g., interest on mortgages, taxes, insurance, repairs, janitor service, fuel and light, etc.

Credit With:

(1) Gross income derived from properties rented.

Balance:

Represents net income from rentals, and should be transferred semi-annually to the credit of " Profit and Loss."

(b) *From Stocks of Other Companies.*

Debit With:

(1) Losses sustained on stocks sold.

Credit With:

(1) Income (dividends) derived from stocks owned. (2) Profits realized on stocks sold.

Balance:

Represents the net income from stocks of other companies, and should be transferred semi-annually to the credit of "Profit and Loss."

§ 178. Expenses.

(a) *Selling.*

Debit With:

(1) All expenses incurred as a result of maintaining the selling department. (2) Direct expenses of carrying stock, such as storage, insurance, expenses incurred by consignees in connection with goods carried by them on consignments, etc. (3) Expenses of the shipping department.

Credit With:

(1) Any items which should result in diminishing charges to this account (contras).

Balance:

Should be transferred semi-annually to the debit of "Profit and Loss."

(b) *General and Administrative.*

Debit With:

(1) All expenses applicable to the administrative department. (2) All expenses that are general to the business considered as a unit. (The class of expenses ordinarily charged to this account are enumerated in Chap. XIV, § 111.)

Credit With:

(1) Contra items.

Balance:

Should be transferred semi-annually to the debit of "Profit and Loss."

(c) *Manufacturing.*

Debit With:

(1) All expenses incurred in connection with the produc-

tion department. (2) Cost of non-productive labor supervision, factory clerk hire, engine room labor, etc. (3) Estimated monthly depreciation of machinery and equipment, and small tools. (4) Estimated taxes on machinery, small tools, raw materials and factory supplies. (For list of items chargeable to this account, see § 117.)

Credit With:

(1) Contra items.

Balance:

At the close of each month transfer the balance of this account to the debit of "Manufacturing" account. The amount thus transferred should be apportioned amongst the active jobs or processes.

§ 179. Discounts.

Debit With:

(1) Footing of the "Discount" column per cash receipts book. (Entry made at close of each month.) This footing should represent cash discounts allowed to customers.

Credit With:

(1) Footing of the "Discounts" column per cash disbursements book. (Entry made at close of each month.) This footing should represent cash discounts allowed by creditors.

Balance:

Should be transferred semi-annually to "Profit and Loss."

§ 180. Dividend Account.

Debit With:

(1) Dividends paid.

Credit With:

(1) Dividends declared.

Balance:

Represents dividends due but not paid. (See § 188.)

§ 181. Subscriptions to Stock.

Debit With:

(1) Par value of stock subscribed for, at which time credit "Subscribed Stock."

Credit With:

(1) All moneys received on account of subscriptions.

Balance:

Represents unpaid subscriptions.

§ 182. Subscribed Stock.

Debit With:

(1) Par value of shares when fully paid, at which time credit capital stock account, common or preferred, as the case may be.

Credit With:

(1) Par value of stock subscribed for, at which time charge "Subscriptions to Stock" account.

Balance:

Represents the aggregate par value of stock subscribed for but not fully paid.

§ 183. Cash Sales.

Debit With:

(1) Footing of "Cash Sales" column per summary of sales book, at the close of each month, thus causing the account to balance.

Credit With:

(1) Footing of "Cash Sales" column per cash receipts book. (Entry made at close of each month.) This footing should represent the total cash sales for a month.

CHAPTER XVII.

SPECIAL ENTRIES OF CORPORATE BOOKS.

§ 184. Characteristic Entries.

The only new features introduced into the books of account when a private or partnership business is transferred to a corporation are those which relate directly to the mechanism of the corporate form. Thus the interests of the parties forming the corporation are represented by stock and a "Capital Stock" account is necessary. Profits when divided are declared as dividends and a "Dividend" account must be opened. Stock returning to the corporation either by purchase or by donation becomes treasury stock and a "Treasury Stock" account is required. The corporate losses or gains find their ultimate resting place in a "Surplus" account. Bonds when issued require a "Bond" account, and accounts must also be kept with the interest on these bonds as it accrues from month to month.

The various entries in the corporate accounts which follow in the present chapter are merely intended to show the debits and credits resulting from the transactions considered. For the sake of clearness, they are expressed in the form of journal entries regardless of whether these entries belong in the cash book or in the journal. It will therefore be understood that the expression of a cash entry in this form is not intended to indicate its inclusion in the journal.

(1) ENTRIES RELATING TO SALE OF STOCK.

§ 185. Sale of Stock.

(a) *Stock Sold at Par.* If on the organization of a corporation its stock is issued at par for cash or property, or both, the entries are simple. The incoming cash or property is debited, and the outgoing "Capital Stock" is credited.

Thus a corporation may be formed with a capital stock of $100,000 to take over patents valued at $60,000, the balance of the stock being sold at par for cash to provide working capital. The entries are then as follows:—

Cash	$40,000	
To Capital Stock		$40,000
400 shares of stock issued at par for cash.		

This will, of course, appear in the cash book. The property entry will appear in the journal as follows:—

Patent Rights	$60,000	
To Capital Stock		$60,000
600 shares of stock issued at par for patent rights.		

When posted this gives a total credit to capital stock of $100,000, which shows that the entire capital stock has been issued and is outstanding as a technical corporate liability.[1]

If the capital stock consists of preferred and common stock, an account must be opened with each of these, the two accounts taking the place of the "Capital Stock" account. Thus in the preceding transaction if the stock issued for cash were preferred stock and that issued for property were common stock, the two foregoing entries would appear as follows:—

Cash	$40,000	
To Preferred Stock		$40,000
400 shares preferred stock at par for cash.		

[1] See § 331.

Patent Rights	$60,000	
To Common Stock		$60,000

600 shares common stock issued at par for patent rights.

(b) *Stock Sold Above or Below Par.* The laws never prohibit the sale of capital stock at more than par but usually forbid its sale on original issue at less than par.[2] As a rule no penalty is imposed beyond the liability incurred by the purchasers for the unpaid balance, but this liability is objectionable and sufficient to render issues of stock at less than par infrequent.

Issues of stock at more than par are also unusual in industrial corporations, though customary in the case of national and state banks and trust companies. In any case of sales on original issue above par the amount received in excess of par goes to "Surplus" account. "Cash" is debited with the entire amount coming in, "Capital Stock" is credited with the full par value of the stock issued, and the excess is credited to "Surplus." Thus if a bank is organized with a capital stock of $100,000, with shares of the par value of $100 and these are sold at $150 per share, the entry would be as follows:—

Cash	$150,000	
To Capital Stock		$100,000
" Surplus		50,000

If stock is sold by the corporation at less than par, the difference represents a nominal loss; i. e., the capital stock issued represents a bookkeeping liability to its full par value, and the difference between the liability so incurred and the actual values received represents a deficit (the antithesis of surplus). Thus if a corporation is formed with a capital stock of $100,000 and its hundred dollar shares are sold on original issue for $75 per share, the proper debits and credits are as follows:—

[2] See § 334.

Cash	$75,000	
Deficit	25,000	
To Capital Stock		$100,000

It is but seldom that stock is sold below par on an original issue and the foregoing entries are therefore rarely employed. Usually when stock is sold below par it is taken from treasury stock and in that case different entries are required.[3]

(c) *Stock Sold on Instalments.* When capital stock is sold on instalments, the stock certificates are not issued until the final payments have been received and the simplest method of handling the transaction is to open two temporary accounts, "Subscriptions to Stock" and "Subscribed Stock," in which the matter may be kept until the final entries are made.

Thus assuming that 1,000 shares of stock of the par value of $100 each are subscribed for, payment to be made in five instalments of 20 per cent. each, the first entry would be as follows:—

Subscriptions to Stock	$100,000	
To Subscribed Stock		$100,000

1,000 shares subscribed for at par as per details shown hereunder. (Follow by name of subscribers and number of shares subscribed.)

As soon as the first instalment is paid in cash, a cash book entry is made, debiting "Cash" and crediting "Subscriptions to Stock" with the aggregate amount received. Similar entries are made on payment of each instalment until the full amount has been paid. Then the total cash credits to "Subscriptions to Stock" will be $100,000, which balances the account. As soon as the final payments are received, the stock is issued to the subscribers and when this is done the following entry is made:—

[3] See § 186.

Subscribed Stock	$100,000	
To Capital Stock		$100,000

1,000 shares of full paid capital stock issued as follows: (Follow by names of subscribers and number of shares issued to each.)

The two accounts " Subscriptions to Stock " and " Subscribed Stock " now balance, leaving as final results a total debit to " Cash " account of $100,000 and a total credit to " Capital Stock " account of the same amount.

When stock is sold on instalments it is necessary to keep a subsidiary ledger containing accounts with all subscribers to the capital stock. They should be charged with the par value of shares subscribed and credited with moneys paid on account of subscriptions. The results of a trial balance compiled from the subscribers' ledger should correspond with the balance of the account "Subscriptions to Stock" in the general ledger.

If subscribers to stock default in the payment of instalments, it is customary to cancel the subscriptions rather than institute legal proceedings to recover any balance due, amounts already paid in being retained in lieu of damages sustained. In any such case a journal entry should be made, debiting " Subscriptions to Stock " and crediting " Surplus " account with the amount of payments forfeited. Another journal entry should then be made, cancelling the subscriptions and closing the subscription accounts, by debiting " Stock Subscribed " and crediting " Subscriptions to Stock."

(d) *Stock Sold in Part.* The statutes usually require that when a corporation is organized some portion of its capital stock shall be issued, or at least be subscribed for, before the active corporate operations are begun. Thus in New York a corporation may not begin business until at least $500 shall have been paid in on stock subscriptions, either in money or property. Also of necessity some stock must be issued before the corporation can exist as an active business organization. Beyond these requirements, however, the corporate authorities have full discretion as to how much of the capital stock shall be issued. They may issue any part or all as they see fit and in practice a partial issue of the total authorized capital stock is common.

Thus a corporation with a view to future needs may be organized with a capital stock of $50,000, while the cash and property to be immediately taken over aggregate but $25,000. In such case "Capital Stock" account is credited with the $25,000 of stock actually issued, but the remainder of the authorized capital stock does not appear upon the books of account at all until it is also actually issued. Until that time it is neither an asset nor a liability of the corporation and has no place in the corporate books of account. It is not treasury stock and should not be so entered.[4]

§ 186. Stock Donated to Treasury.

In the organization of industrial and mining corporations and particularly in those of a more speculative nature, donations of stock to the treasury are customary and give rise to some of the most unsatisfactory entries of corporate bookkeeping.

Any donation to a commercial undertaking is anomalous but when this donation takes the form of stock of indeterminate value, and when this stock has just been issued by the corporation to which it is donated, the transaction is still further removed from the realm of ordinary business and its proper entry is difficult.

The object of such a donation or return of stock, following so closely on its issue, is to provide the corporation with treasury stock which can be sold below par without involving the purchaser in liability.[5] It is usually of much importance for the corporation to have such stock, and therefore—as long

[4] See § 333.
[5] See § 334.

as the laws relating to full paid stock exist in their present form—transactions of this kind are inevitable.

When its own stock returns to a corporation, whether by donation or purchase, it is from the accounting standpoint an asset and is debited to "Treasury Stock," at the price paid in the case of purchased stock, but at its estimated value in the case of donated stock. The corresponding credit in case of purchased stock, if for cash, is of course in the "Cash" account, but in the case of donated stock the account in which the credit is made will vary according to the method of record adopted. There are in common use two methods of recording the transactions of donated stock.

(a) *First Method of Entry.* Under this method when stock is donated to the corporation a new account is created, frequently termed "Working Capital" but better designated "Donation" account, and this new account is credited with the donated stock. Thus if a corporation is organized with a capital stock of $75,000 which is all issued in payment for property, and stock of the face value of $10,000 is returned to be sold to secure operating capital, or for the general purposes of the corporation, the entries would—if the stock were salable at par—be as follows:—

Treasury Stock	$10,000	
To Donation		$10,000

Stock donation of 100 shares to treasury to be sold to provide working capital.

When the stock is sold the sale would be entered as follows:—

Cash	$10,000	
To Treasury Stock		$10,000

100 shares of treasury stock sold at $100 per share.

The "Donation" account is then closed as follows:—

Donation	$10,000	
To Surplus		$10,000

This gives an apparent gain to the corporation of $10,000. Whether such a surplus is a real gain, applicable to dividends, is to be determined by conditions, and is for the directors of the particular corporation to decide. As a matter of fact such a surplus is in most cases practically taken out of capital and its use for dividends is of doubtful propriety. If the stock was donated to the corporation for some specific purpose, as to raise working capital, its use for dividends would be manifestly improper.

When stock is donated to a corporation it is but rarely that it can be sold at par, and donated stock is therefore entered at such less price as the corporate authorities think it will produce. Thus in the case just instanced, if instead of $100 per share the stock were expected to bring but $50 per share, it would be entered upon the corporate books at that figure, the entries then appearing as follows:—

Treasury Stock	$5,000	
To Donation		$5,000

100 shares of stock donated to treasury; estimated value $50 per share.

If sold at $50, the entries would be similar to those already given, cash being debited and treasury stock credited with the amount received, and "Donation" account being closed into "Surplus" as before.

If, however, the stock when sold produced a larger price than was expected, say $60 per share, the entries would be as follows:—

Cash	$6,000	
To Treasury Stock		$5,000
" Donation		1,000

100 shares of treasury stock originally donated and debited to "Treasury Stock" at $50 per share but sold at $60 per share.

This gives a total credit in " Donation " account of $6,000 which equals the amount really received from the sale of the donated stock, and " Donation " account is then closed into " Surplus " by a journal entry.

If, on the other hand, the treasury stock sold at less than the estimated value, say for instance at $40 per share, the cash entry would be as follows:—

Cash	$4,000	
To Treasury Stock		$4,000

The difference between the estimated and actual value of the stock is then debited to " Donation " account as follows:—

Donation	$1,000	
To Treasury Stock		$1,000

100 shares of stock donated to treasury and entered at $50 per share, but sold at $40 per share.

This shows a credit balance in " Donation " account of $4,000 which is the real value of the stock donated, and " Donation " account is then closed into surplus. The same end might be attained if desired by a single entry as follows:—

Donation	$5,000	
To Surplus		$4,000
" Treasury Stock		1,000

The objection to this general method of recording donated stock lies in the fact that it shows an apparent gain to the corporation before active operations have begun and when all its assets consist of the property taken over and of the donated stock, the value of which rests upon this same property. Manifestly this apparent gain may be entirely fictitious. If the property for which the stock was originally issued was actually worth the face value of the entire amount of stock issued in payment therefor, the gain from donated stock is real. It is, however, but seldom that the value of property taken over by a corporation is conservatively estimated and the gains of donated stock are then usually fictitious and misleading.

(b) *Second Method of Entry.* Donations of stock almost invariably consist of stock which is first issued in exchange for property and is then by agreement with the owners of the property returned for the purposes of the corporation. Under the second method of entry this return of stock is considered as if it were a concession on the price of the property for which it was issued, and the value of the returned stock is accordingly credited to this same property account. This reduces the book cost of the property to the corporation but does not show any immediate profit. The method is therefore more conservative than the one first presented and is perhaps to be preferred.

Thus if a corporation is formed with a capital stock of $100,000 and this entire amount is issued in payment for patent rights, $25,000 face value of this stock being then returned to be used for the purposes of the corporation, the entries under the second method would be as follows:—

On issuance of stock;

Patent Rights	$100,000	
To Capital Stock		$100,000

When the donation of $25,000 face value of the stock is received, it is credited to "Patent Rights" at the price at which it is expected to be sold. Thus if the $25,000 face value of stock returned was expected to be sold at $50 per share, the entries would be as follows:—

Treasury Stock	$12,500	
To Patent Rights		$12,500

250 shares of stock valued at $50 per share donated to treasury for purposes of corporation.

If this stock is sold at the price expected, the cash entries would show the following debits and credits:—

Cash	$12,500	
To Treasury Stock		$12,500

250 shares of treasury stock at $50 per share.

If, however, the stock should sell at more than $50 per share, say $60 per share, the excess must go to "Patent Rights" in order to show the true rebate or concession made on the price. The entry would therefore be as follows:—

Cash	$15,000	
To Treasury Stock		$12,500
" Patent Rights		2,500

250 shares of treasury stock sold at $60 per share. Originally credited to "Patent Rights" at $50 per share.

Likewise if the stock sold at less than $50 per share, say $40, the deficiency must be debited to "Patent Rights" as shown in the following entry:—

Cash	$10,000	
Patent Rights	2,500	
To Treasury Stock		$12,500

This reduces the net credit on patent rights to the amount actually realized from the sale of the treasury stock.

The advantage of the second method lies in its conservative presentation of the conditions. Under the first method, as already stated, a gain is shown before the corporation has even begun its active operations. Under the second method no immediate gains are shown as a result of the stock donation. Perhaps at some later date when the books are balanced, an inventory of the property will show a value in excess of its cost as shown by the property account, but in this case the apparent gain to the corporation is presumably real and is properly transferred to surplus.

An objection sometimes urged against the method is found in the fact that the entry may perhaps by inference cast some reflection upon the directors' usual statement in their resolution of acceptance that the property " is of the reasonable value of the stock issued therefor." This is a matter for the treasurer of the corporation and the directors to consider and decide for themselves. The objection has no legal weight.

§ 187. Payment by Stock.

(a) *Salaries Paid in Stock.* Not infrequently the salaries of the managers and sometimes the officers of corporations are paid partially in stock. The procedure is not improper under suitable conditions and the entries are simple. Such stock salaries might be paid monthly if so agreed, but, even when based on monthly instalments, are usually allowed to accumulate and paid at fixed intervals. In either case, if the salary is paid by an original issue of stock the proper salary, or expense account, as the case may be, will be debited and " Capital Stock " account will be credited with the full face value of the stock issued. Presumably the stock is taken at its par value but, if not, any excess over par is credited to " Surplus " or, if taken below par, the difference between this price and par is debited to " Surplus," or " Deficit."

If payment is made from treasury stock, the proper expense account will be debited and " Treasury Stock " account will be credited.

(b) *Commissions Paid in Stock.* Commissions paid in stock create no unusual bookkeeping entries. If paid by issue of original stock, " Commission " account—or such other expense account as the commissions may be charged to—is debited and " Capital Stock " account is credited. If, as is usually the case, the commissions are paid from treasury stock, the proper expense account will be debited and "Treasury Stock" will be credited.

(c) *Bonus Paid in Stock.* When bonuses are paid in stock the stock is issued without any direct consideration. Such issues are not necessarily improper as they usually enable the sale of bonds, or preferred stock, or other securities, which results in direct benefit to the corporation. The particular stock given as a bonus, however, apparently goes out without value being received in return and will, as a matter of course, be taken from treasury stock. A "Bonus" account is opened and the entries are made on the basis of the price at which the stock was debited to "Treasury Stock" account.

Thus if $10,000 face value of stock is given from treasury stock as a bonus and this stock has been debited to "Treasury Stock" at fifty cents on the dollar, the entry would be as follows:—

Bonus	$5,000	
To Treasury Stock		$5,000

100 shares of stock originally entered at $50 per share, given as a bonus with 100 shares of preferred stock sold at par.

"Bonus" account would thereafter be treated as part of the organization expenses which are often written off over a period of years.

§ 188. Dividends.

(a) *Dividends Paid in Cash.* When all the stock of a corporation is common stock, one dividend account is sufficient. If, however, both common and preferred stock is issued, two accounts are necessary, headed respectively "Dividends on Preferred Stock" and "Dividends on Common Stock." When a dividend is declared,[6] a journal entry is made debiting

[6] See § 250.

"Surplus" and crediting the proper dividend account. A check is then issued for the amount of the dividend declared, is credited to "Cash" and charged to the proper dividend account, thus causing it to balance. This check should be deposited to the credit of a special bank account and the dividend checks mailed to stockholders should be drawn against this special bank account. In the smaller corporations dividend checks are usually drawn against the general cash account and are debited to "Dividends" when drawn.

A dividend ledger should be kept for the purpose of showing a record of the dividends declared and dividends paid to stockholders. Such a record is of special importance in the case of cumulative preferred stockholders where, if not paid in any year, the dividends are carried over as a charge against profits until such times as they can be paid.

(b) *Dividends Paid in Stock.* Profits must exist before dividends may be declared.[7] Occasionally, however, it happens that profits properly applicable to dividends exist but the directors deem it wise to retain these profits for the purposes of the corporation. In such cases and particularly where the profits are to be expended on such betterments or additions to the corporate properties as are properly chargeable to "Capital" account, dividends are not infrequently declared in stock. Stock must, of course, be available for the purpose or otherwise an increase of capital stock must be legally authorized before a stock dividend may be paid. Thus the Missouri-Pacific Railroad recently substituted a stock dividend for its usual cash dividend, the stock used for this purpose being taken from an increase of stock, authorized some years before but not issued.

Unless there are statutory prohibitions, stock may be issued directly to the stockholders in payment of dividends as full paid stock. In any case, as soon as the dividend is declared, it becomes a debt of the corporation due to the stockholders, and the following entry is made:—

[7] See Chaps. XXIV and XXV.

Surplus	$50,000	
To Dividend		$50,000

Semi-annual 2 per cent. dividend declared this day on the entire capital stock of the corporation, payable in stock.

When stock is issued to the stockholders in payment of this debt the entry will be as follows:—

Dividend	$50,000	
To Capital Stock		$50,000

500 shares of stock issued this day to stockholders as per dividend ledger, payment of semi-annual 2 per cent. dividend.

(c) *Dividends Paid in Scrip.* When profits are not immediately available for dividends, or are desired for other purposes, dividends are frequently paid in scrip. Thus the Erie Railroad recently passed its usual cash dividend on its first and second preferred stock, issuing in lieu thereof a scrip dividend of equal amount. In such case an account must be opened with scrip and the entries, assuming the amount of the dividend to be $100,000, would be as follows:—

Surplus	$100,000	
To Dividend		$100,000

Quarterly dividend of 2 per cent. on capital stock declared this day payable in scrip.

Dividend	$100,000	
To Scrip		$100,000

Two per cent. dividend on stock of company paid in scrip (with details of scrip issue).

Scrip sometimes runs many years before payment. When it is paid, cash is credited with the amount and "Scrip" account is debited, closing the account.

§ 189. Purchases of Stock.

(a) *Corporation Purchasing Its Own Stock.* Under some circumstances a corporation may legally purchase its own stock. In such case "Treasury Stock" account is debited with the amount actually paid for the stock and "Cash" account is credited.

(b) *Purchasing Stock of Other Corporations.* A corporation may only acquire stock of another corporation when it is expressly authorized thereto by its charter or by the statutes of the state. When stock of another corporation is purchased, it is not treasury stock but goes into an entirely separate and distinct account, usually headed "Stocks of Other Companies." "Cash" account is credited and the stock purchased is debited to "Stocks of Other Companies" at the price actually paid, and when such stocks are sold they are credited to this same account at cost. "Profit and Loss" is credited or charged, as the case may be, with the difference between the cost and selling price.

(2) OPENING ENTRIES FOR CORPORATE BOOKS.

§ 190. Books of a Manufacturing Corporation.

(a) *Statement.* A corporation is formed to purchase patents and begin a manufacturing business under the patents so obtained. Its capital stock is fixed at $150,000, all of which is to be issued for the patents. $25,000 of the stock so issued is by agreement to be returned to the corporation and to be sold thereafter for working capital. The treasury stock is expected to sell for cash at the rate of 50 cents on the dollar.

(b) *Entries in Books.* The opening entries for the corporate books would be as follows:—

Patent Rights	$150,000	
To Capital Stock		$150,000

Entire capital stock issued in payment for patents.

Treasury Stock	$12,500	
To Patent Rights		$12,500

250 shares of stock donated to treasury to be sold to secure working capital. Estimated selling price of stock, $50 per share.

If all the stock is sold, the following entries will be made:—

Cash	$12,500	
To Treasury Stock		$12,500

Sale of 250 shares of stock at $50 per share.

If the stock does not sell at the expected price, adjusting entries must be made as given in § 186 (b).

§ 191. Books of a Mining Corporation.

(a) *Statement.* A corporation is formed with a capital stock of $500,000, to take over the Lone Star Mining property valued at $300,000, and options on certain other properties of the estimated value of $200,000, the entire stock of the corporation to be issued at its par value in payment for said property and options. By agreement with the owners of the property, $300,000 face value of the stock so issued is to be returned to the corporation and is to be sold to secure working capital. Shares are of the par value of $1 each and the first 100,000 shares are to be sold at 10 cents on the dollar; the second 100,000 at 20 cents on the dollar and the third 100,000 at 50 cents on the dollar. All stock is common stock.

(b) *Entries in Books.* The entries in the corporate books would be as follows:—

Lone Star Mine	$300,000	
Options	200,000	
To Capital Stock		$500,000

Lone Star Mine purchased for 300,000 shares of stock at par. Options on mining claims purchased for 200,000 shares of stock at par.

If the method of crediting donated stock to property accounts is preferred, the stock donation of 300,000 shares might be pro-rated between the two property accounts, $48,000 being credited to "Lone Star Mine" account and $32,000 to "Options" account. If a "Donation" account is preferred, the entries would appear as follows:—

Treasury Stock	$80,000	
To Donation		$80,000

300,000 shares of stock donated to treasury. 100,000 shares estimated at 10 cents per share; 100,000 shares at 20 cents per share, and 100,000 shares at 50 cents per share.

As stock is sold from the first lot, "Cash" is debited and "Treasury Stock" is credited, the entries being, of course, made at the price actually received for the stock. As the second lot is sold, entries are likewise made, and as the third lot is sold entries are made in the same manner until with the final sale "Treasury Stock" account should balance.

"Donation" account is then closed into "Surplus" account.

Donation	$80,000	
To Surplus		$80,000

Entry to close "Donation" account.

If stock sells above or below the anticipated price, the foregoing entries would be modified to meet the conditions. Each excess or deficit as it arises should be entered to the credit or debit, as the case may be, of "Donation" account. If, however, sales were numerous and varied as to prices, and the amounts received at any one time were small, the entire receipts might be credited to "Treasury Stock" account and adjusting entries be made at intervals. Thus if the first 100,000 shares sold at an average price of 12 cents, and the entire amount was credited to treasury stock, the excess credit of $2,000 in "Treasury Stock" account must be credited to "Donation" account as follows:—

Treasury Stock	$2,000	
To Donation		$2,000

Adjusting entry for 100,000 shares treasury stock originally entered at 10 cents but sold at average price of 12 cents per share.

If the average price were below the estimated price, say 8 cents per share, "Treasury Stock" account must be credited, the entry then appearing as follows:—

Donation	$2,000	
To Treasury Stock		$2,000

Adjusting entry for 100,000 shares treasury stock originally entered at 10 cents but sold at average price of 8 cents per share.

§ 192. Books of an Incorporated Partnership.

(a) *Old Books Continued.* If the partnership books are to be continued as the corporate books when a partnership is incorporated, the procedure is simple. The accounts of the partnership books are balanced, those showing loss or gain are closed into "Profit and Loss" account, and this account is then charged off to the individual accounts of the partners. The capital stock of the corporation is then so issued as to close these partnership accounts.

Thus the partnership books when closed may show a present worth of $100,000 divided between three partners, as follows:—

John Wilson	$35,000	
Henry Jones	20,000	
James Arnold	45,000	
		$100,000

The corporation taking over the business will usually be capitalized at this same amount, i. e., $100,000, and this entire capital stock is issued in payment for the business. The entry in the partnership books will appear as follows:—

John Wilson	$35,000	
Henry Jones	20,000	
James Arnold	45,000	
To Capital Stock		$100,000

1,000 shares of capital stock issued to John Wilson, Henry Jones and James Arnold, in payment for the business taken over by the corporation.

This closes the partners' accounts, opens the capital stock account and is the only entry requisite to transform the partnership books into the corporate books. The other accounts of the partnership remain in the books exactly as before. Additional corporate entries will probably be necessary later but not at this point.

(b) *New Books Opened.* When a corporation is formed to take over a partnership business and new books are to be opened, the operation is naturally more complex, as a transfer of all the property accounts from the old books to the new is involved. Thus the partnership books may show the following assets and liabilities:—

ASSETS:		*LIABILITIES:*	
Cash	$10,000	Notes Payable	$18,000
Accts. Receivable	10,000	Accounts Payable	12,000
Bills Receivable	18,000	Rentals	1,000
Finished Products	25,000	Present Worth	75,000
Raw Materials	18,000		
Machy. & Equipm't	25,000		
	$106,000		$106,000

This shows a present worth of $75,000. As far as the new books are concerned, the individual ownership of this $75,000 is of no importance. The corporation takes over the business as a whole without regard to individual ownerships therein. The partners' interests will probably show on the stock books of the corporation, but not in the account books.

In the present case a corporation might perhaps be organized with a capital stock of $100,000, of which $75,000 is to be issued in payment for the partnership business, $25,000 being reserved for future enlargement. Capital stock is issued at par in payment for the assets of the business taken over. The debits and credits on the new books are then as follows:—

Cash	$10,000	
Accounts Receivable	10,000	
Bills Receivable	18,000	
Finished Products	25,000	
Raw Materials	18,000	
Machinery and Equipment	25,000	
To Capital Stock		$75,000
" Notes Payable		18,000
" Accounts Payable		12,000
" Rentals		1,000

750 shares of stock issued in payment for the partnership business of Wilkens and Freeman, with assets and liabilities as shown above.

The above entry gives all the items for the opening of the new set of corporate books. The cash entry would, of course, appear only in the cash book, debited with "Capital Stock."

In this case good-will does not appear among the assets. It could very properly appear there, and, unless the corporation is to be run strictly as a close corporation and kept in the hands of the original owners, should appear. Its amount should be estimated at a fair figure[8] and appear among the assets, increasing them by just that amount.

(c) *Entries Closing Partnership Books.* In closing up the old partnership books the first entries will be as follows:—

[8] See § 146.

Wilkens and Freeman Co.	$106,000	
To Cash		$10,000
" Accounts Receivable		10,000
" Bills Receivable		18,000
" Finished Products		25,000
" Raw Materials		18,000
" Machinery and Equipment		25,000

Assets taken over by Wilkens and Freeman Company in purchase of partnership business.

The next entry will appear as follows:—

Notes Payable	$18,000	
Accounts Payable	12,000	
Rentals	1,000	
To Wilkens and Freeman Co.		$31,000

Liabilities assumed by Wilkens and Freeman Co. in purchase of partnership business.

These two entries when posted close all the asset and liability accounts of the partnership business and open an account with the Wilkens and Freeman Company with a net debit of $75,000. The accounts of the partners are still open and should show a credit of $75,000. Assuming that the partners' interests are respectively $40,000 and $35,000 and that stock of the Wilkens and Freeman Company has been turned over to the partnership in payment for the business, to the par value of $75,000, the next and final entry will be as follows:—

John H. Wilkens	$40,000	
Henry Walsh Freeman	35,000	
To Wilkens and Freeman Co.		$75,000

This entry when posted balances the account of the Wilkens and Freeman Company and also the partners' accounts, thereby closing the partnership books.

CHAPTER XVIII.

THE TREASURER'S REPORT.

§ 193. Report to Directors.

(1) *Requirements.* In the smaller corporations the directors usually keep in close touch with both the corporate business and its records, and a formal report from the treasurer will hardly be required more than once a year.

In the larger corporations monthly reports showing the condition of the corporate affairs are usually required, the details and scope of these reports depending somewhat on the nature of the corporate business. An annual report is also made at the end of the corporate year, usually similar in form to the monthly reports but covering the operations of the entire year.

There should be no reservations in the treasurer's report to the directors. The directors are responsible for the management of the business and should be fully informed on every detail of the corporate operations that will assist them in the intelligent and capable discharge of this responsibility. Occasionally it will happen that special transactions are not divulged to the entire board of directors, but this is exceptional and is only proper when the directors themselves concur.

The treasurer's report, whether monthly, quarterly or annual, should, for the period covered, give the source and amount of moneys received, the amount and nature of disbursements, the earnings and expenses, and the assets and liabilities as of the close of the reported period. Any special data peculiar to the particular time or period, or of importance to the financial operations of the corporation, should also be embodied in the treasurer's report.

(2) *Form of Report.* The form of treasurer's report submitted on the following pages is one frequently employed. The statement as presented is a monthly report in comparative form, not only giving the data for the month covered by the report but for the same month of the preceding year. This enables the directors to see at a glance the present condition of the business and its progress, both general and by departments.

The first exhibit of the following report—(a) "Summarized Statement of Cash Receipts and Disbursements"—shows the moneys received and disbursed during the month covered by the report and also for the corresponding month of the previous year.

The second exhibit—(b) "Comparative Balance Sheet"—is a comparative statement of assets and liabilities as at the close of the month of the report.

The third exhibit—(c) " Comparative Profit and Loss Statement "—is a statement of the earnings and expenses for the month of the report, together with the earnings and expenses for the corresponding month of the previous year. The expenses are not detailed in this statement, reference being made to the analysis book which shows in comparative form the detailed expenses of each month. This book should accompany the report when it is submitted to the directors. This avoids the necessity of detailing all expenses in the report, which should be done if an analysis book is not kept or is not presented to the board.

The treasurer's annual report to the directors should follow the general form of the monthly report.

(*a*) SUMMARIZED STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS.

CLARK & GILCHRIST, INC.

	MARCH, 1908.		MARCH, 1907.	
Cash in banks and on hand February 28th		$26,000 00		$19,750 00
Receipts.				
Trade debtors	$67,439 76		$58,466 22	
Cash sales	1,562 40		2,142 85	
Sale of two horses	360 00			
Insurance claim adjusted			2,316 40	
Interest on deposits	43 33	69,405 49	37 21	62,962 68
		$95,405 49		$82,712 68
Disbursements.				
Trade creditors	$53,621 60		$47,214 45	
Officers' salaries	1,800 00		1,800 00	
Office help	675 00		560 00	
Office supplies and postage	343 27		185 00	
Salesmen's salaries	1,600 00		1,300 00	
Salesmen's expenses	754 20		527 25	
Advertising	1,262 26		2,765 75	
Credit man's salary	350 00		300 00	
Store pay roll	2,420 00		1,850 00	
Store supplies	265 45		562 60	
Stable pay roll	450 00		400 00	
Stable supplies	86 50		184 50	
Freight inward	320 51		275 48	
Freight outward	626 00		843 26	
Rent	1,200 00		1,200 00	
Insurance	216 00		184 70	
Telephone (February)	54 00		49 50	
Telegrams	14 50		27 64	
Miscellaneous	76 50	66,135 79	153 16	60,383 29
Balance in banks and on hand March 31st		$29,269 70		$22,329 39

B. H. GRESSIVE,

Treasurer.

April 6, 1908.

(*b*) COMPARATIVE BALANCE SHEET.

CLARK & GILCHRIST, INC.

	MARCH 31, 1908.		MARCH 31, 1907.	
Assets.				
Store equipment	$9,245 00		$8,762 50	
Office equipment	1,012 40		974 00	
Stable equipment	3,218 90		3,420 00	
Interior alterations	4,720 00		4,720 00	
	$18,196 30		$17,876 50	
Deduct:				
Reserve for depreciation (10%).	5,624 00	12,572 30	4,108 55	13,767 95
Cash	$29,269 70		$22,329 39	
Accounts receivable	91,414 14		79,871 40	
Notes receivable	11,421 50		4,624 00	
Merchandise on hand	176,421 27		128,643 96	
Supplies on hand	1,641 00		2,314 22	
Insurance unexpired	197 44	310,365 05	153 26	237,936 23
Total Assets		322,937 35		251,704 18
Liabilities.				
Accounts payable	$122,962 40		$91,416 29	
Notes payable	51,762 00		46,745 00	
Accrued taxes (estimated).	278 00		314 00	
Reserve for doubtful accounts	1,370 00	176,372 40	1,197 00	139,672 29
Capital Stock:				
Common	$50,000 00		$50,000 00	
Preferred	50,000 00	100,000 00	50,000 00	100,000 00
Surplus:				
Balance February 28th	$37,240 35		$6,189 23	
Net profit for March	9,324 60	46,564 95	5,842 66	12,031 89
		$322,937 35		$251,704 18

(*c*) COMPARATIVE PROFIT AND LOSS STATEMENT.

CLARK & GILCHRIST, INC.

	MARCH, 1908.		MARCH, 1907.	
Net sales of "A"	$21,647 26		$16,214 71	
Cost	16,340 80		11,862 50	
Gross profit		5,306 46		4,352 21
Net sales of "B"	$27,477 80		$18,610 16	
Cost	21,263 55		14,366 50	
Gross profit		6,214 25		4,243 66
Net sales of "C"	$32,314 50		$30,764 55	
Cost	23,667 15		21,840 62	
Gross profit		8,647 35		8,923 93
Net sales of "D"	$11,426 44		$3,516 40	
Cost	8,216 00		2,746 27	
Gross profit		3,210 44		770 13
Total gross profit		$23,378 50		$18,289 93
Deduct:				
Selling expenses (For details see Analysis Book.)	$8,289 20		$7,527 50	
General and administrative expenses	4,379 27		4,234 68	
(For details see Analysis Book.)		12,668 47		11,762 18
Net profit before deducting items of interest, discounts, loss on bad accounts, etc.		10,710 03		6,527 75
Deduct:				
Net interest charges:				
On borrowed moneys	820 50		516 40	
Discounts on sales, etc.	674 63		428 12	
	$1,495 13		$944 52	
Less:				
Discounts on purchases	$525 90		$591 88	
	$969 23		$352 64	
Reserved for doubtful accounts	416 20	1,385 43	332 45	685 09
Net profit (see Balance Sheet)		$9,324 60		$5,842 66

§ 194. Report to Stockholders.

(1) *Requirements.* The stockholders compose the corporation and are entitled to information as to its condition and progress. There are, however, frequently trade reasons for withholding the more confidential details from them. It is obvious that if a full showing of the corporate business and the results of its operations were made annually to the stockholders of a corporation, serious results might follow. Primarily for this reason, but also because the stockholders do not need nor usually desire fully detailed statements of the corporate business, the reports made the stockholders are almost always general in their character.

A statement of earnings, such as that of the United States Steel Corporation presented on the following page, gives a very excellent view of the general results of the company's operations and is a good example of a special stockholders' report.

When a more general statement is desirable, a condensed balance sheet such as that of the United States Steel Corporation presented on the later pages of the present chapter, makes an excellent form of report for stockholders. As originally presented, this was accompanied by an Income Account Statement showing the earnings for the year, and also by a condensed general Profit and Loss Account. A large amount of less directly connected matter also accompanied the balance sheet, mainly relating to the operations of subsidiary companies.

(2) Statement of Earnings and Expenditures.

STATEMENT OF

UNITED STATES STEEL CORPORATION AND SUBSIDIARY COMPANIES.

For the Quarter ending September 30th, 1907.

EARNINGS.

July, 1907	$13,804,167
August, 1907	15,279,173
September, 1907	14,720,945

Total Earnings after deducting all expenses incident to operations, including those for ordinary repairs and maintenance of plants, employes' bonus funds, and interest on bonds and fixed charges of the subsidiary companies			$43,804,285
Less, Charges and Appropriations for the following purposes, viz:			
Sinking Funds on Bonds of Subsidiary Companies		$ 589,358	
Depreciation and Reserve Funds (Regular provisions)		6,519,822	
Special Improvement and Replacement Funds		1,000,000	
			8,109,180
Net Earnings			$35,695,105
Deduct:			
Interest for the quarter on U. S. Steel Corporation Bonds outstanding		$ 5,633,122	
Sinking Funds for the quarter on U. S. Steel Corporation Bonds, viz:			
Instalments	$1,012,500		
Interest on Bonds in Sinking Funds	291,340		
		1,303,840	
			6,936,962
Balance			$28,758,143
Dividends for the quarter on stocks of the United States Steel Corporation, viz: *			
Preferred, 1¾%		$6,304,919	
Common, ½%		2,541,513	
			8,846,432
Surplus for the quarter			$19,911,711
Less, appropriated from Surplus for the following purposes, viz:			
On account of expenditures made and to be made on authorized appropriations for additional property, new plants, construction and discharge of capital obligations			15,000,000
Balance of Surplus for the quarter			$4,911,711

W. J. FILBERT,
Comptroller.

*Dividends Payable: Preferred, November 30, 1907; books close November 6, open December 2. Common, December 30, 1907; books close December 9, open December 31.

UNFILLED ORDERS ON HAND.

September 30th, 1907..................6,425,008 Tons.

UNITED STAT

CONDENSED GENERAL BALA

ASSETS.

PROPERTY ACCOUNT:			
PROPERTIES OWNED AND OPERATED BY THE SEVERAL COMPANIES:			
Balance of this account as of December 31, 1905		$1,380,031,032.25	
Adjustments during 1906 in foregoing balance		84,823.16	
Expended for Additional Property and Construction in 1906		32,155,146.46	
		$1,412,271,001.87	
Less: Charged off to the following accounts, viz.:			
To Bond Sinking Funds	$1,406,500.00		
To Depreciation and Extinguishment Funds	2,063,052.54		
To Funds provided from Surplus Net Income for payment of capital expenditures (see page 12)	30,615,844.26		
		34,085,396.80	
		$1,378,185,605.07	
Expenditures for Stripping and Development at Mines, viz.:			
Balance at December 31, 1905	$4,016,985.45		
Net Increase during the year 1906	1,705,355.16		
		5,722,340.61	
			$1,383,907,945.6
DEFERRED CHARGES TO OPERATIONS:			
Payments for Advanced Mining Royalties, Exploration Expenses and Miscellaneous charges, chargeable to future operations of the properties		$4,272,621.94	
Less: Fund reserved from Surplus to cover possible failure to realize Advanced Mining Royalties		2,500,000.00	
			1,772,621.9
INVESTMENTS:			
Outside Real Estate and Other Property			1,617,351.2
SINKING AND RESERVE FUND ASSETS:			
Cash held by Trustees account of Bond Sinking Funds		$397,287.89	
($24,767,500 par value of Redeemed Bonds held by Trustees, not treated as an asset.)			
Contingent Fund and Miscellaneous Assets		1,542,398.24	
Insurance Fund Assets (at cost)		3,649,970.74	
Depreciation and Extinguishment Fund Assets (at cost)		11,708,499.14	
Investments (at cost) for Special Construction Fund for Gary Plant		10,145,788.59	
			27,443,944.6
CURRENT ASSETS:			
Inventories*		$119,897,466.73	
Accounts Receivable		58,836,772.50	
Bills Receivable, Customers		4,203,933.30	
Agents' Balances		672,576.16	
Sundry Marketable Bonds and Stocks		7,720,348.35	
Loans on Collateral		7,600,000.00	
Cash, viz.:			
In hand and on deposit with Banks, Bankers and Trust Companies subject to cheque	$62,812,418.49		
Deposits loaned on call	2,824,390.35		
Time Certificates of Deposit	2,000,000.00		
		67,636,808.84	
			266,567,905.8
			$1,681,309,769.3

* Inventory valuations include profits accrued to subsidiary companies on materials and products sold to other subsidiary companies and undisposed of by the latter—see contra specific surplus account for these profits. The total of all inventories is, however, below the actual current market prices.

We have audited the above Balance Sheet, and certify that in our opinion it is properly drawn up so as to show the true financial position of the United States Steel Corporation and Subsidiary Companies on December 31, 1906.

PRICE, WATERHOUSE & CO.,
Auditors.

NEW YORK, February 28, 1907.

EL CORPORATION

T, DECEMBER 31, 1906.

LIABILITIES.

PITAL STOCK OF U. S, STEEL CORPORATION:			
Common		$508,302,500.00	
Preferred		360,281,100.00	$868,583,600.00
PITAL STOCKS OF SUBSIDIARY COMPANIES NOT HELD BY U. S. STEEL CORPORATION (*Par Value*)			23,400.00
NDED AND DEBENTURE DEBT:			
United States Steel Corporation 50 Year 5% Bonds	$303,957,000.00		
United States Steel Corporation 10-60 Year 5% Bonds	170,000,000.00		
	$473,957,000.00		
Less: Redeemed and held by Trustees of Sinking Funds	18,956,500.00		
Balance outstanding		$455,000,500.00	
Subsidiary Cos.' Bds. (Guaranteed by U. S. Steel Corp'n)	$48,624,000.00		
Subsidiary Cos.' Bds. (Not guaranteed by U. S Steel Corp'n)	64,307,680.41		
	$112,931,680.41		
Less: Redeemed and held by Trustees of Sinking Funds.	5,811,000.00		
Balance outstanding		107,120,680.41	
Debenture Scrip, Illinois Steel Company		35,069.18	562,156,249.59
PITAL OBLIGATIONS AUTHORIZED OR CREATED FOR CAPITAL EXPENDITURES MADE (HELD IN THE TREASURY SUBJECT TO SALE, BUT NOT INCLUDED IN ASSETS—See page 15):			
U. S. Steel Corporation 10-60 Year 5% Bonds		$30,000,000.00	
Subsidiary Companies' Bonds.		10,320,000.00	
Total, not included in General Balance Sheet Assets or Liabilities		$40,320,000.00	— — —
ORTGAGES AND PURCHASE MONEY OBLIGATIONS OF SUBSIDIARY COMPANIES:			
Mortgages		$2,514,626.37	
Purchase Money Obligations		1,717,500.00	4,232,126.37
RRENT LIABILITIES:			
Current Accounts Payable and Pay Rolls		$23,853,579.40	
Special Deposits or Loans due employes and others		1,077,292.29	
Accrued Taxes not yet due		2,728,361.61	
Accrued Interest and Unpresented Coupons		7,166,344.29	
Preferred Stock Dividend No. 23, Payable February 28, 1907		6,304,919.25	
Common Stock Dividend No. 13, Payable March 30, 1907		2,541,512.50	43,672,009.34
Total Capital and Current Liabilities			$1,478,667,385.30
NKING AND RESERVE FUNDS:			
Sinking, Depreciation and Replacement Funds, per table on page 10		$38,665,489.73	
General Construction Fund for authorized appropriations (see page 12)		3,057,059.15	
Special Construction Fund for account Gary, Ind., Plant (see page 12)		26,867,797.89	
Contingent and Miscellaneous Operating Funds		7,424,705.80	
Insurance Funds		3,741,829.28	79,756,881.85
OND SINKING FUNDS WITH ACCRETIONS			25,164,787.89
Represented by Cash (and by redeemed bonds not treated as assets—See Contra).			
NDIVIDED SURPLUS OF U. S. STEEL CORPORATION AND SUBSIDIARY COMPANIES:			
Capital Surplus provided in organization		$25,000,000.00	
Balance of Surplus accumulated by all companies from April 1, 1901, to December 31, 1906, per table on page 31		54,556,654 01	
Total Surplus exclusive of Subsidiary Companies' Inter-Company Profits in Inventories		$79,556,654.01	
Undivided Surplus of Subsidiary Companies, representing Profits accrued on sale of materials and products to other Subsidiary Companies, on hand in latter's Inventories		18,164,060 34	97,720,714.35
			$1,681,300,769.39

CHAPTER XIX.

THE AUDITOR'S REPORT.

§ 195. General.

It is customary for the by-laws of corporations to provide for periodical audits of the books of account, either by committees consisting of directors or by professional accountants.

In the larger corporations an audit by the directors is practically impossible. In the smaller corporations it is ordinarily inadvisable. If properly conducted an audit is a laborious process, requiring painstaking accuracy and an amount of time that the directors of a corporation are not usually disposed to give it, and demanding a technical knowledge of accountancy that they do not usually possess.

In practice directors' audits do not ordinarily discover the true conditions of the corporate business nor the real results of its operations, and the report of such an audit is not only of no material value but is at times absolutely misleading. For this reason, even when the audit is entrusted to a committee of directors, the actual accounting work should be delegated by them to some independent and capable accountant who is able to perform it properly without fear or favor. The object contemplated by the by-laws is undoubtedly a competent and thorough investigation and an adequate report, and this cannot be attained by the unaided efforts of the ordinary committee of directors.

§ 196. The Objects of an Audit.

Stated briefly, the more important objects of the usual audit examination are to determine,—(1) whether the books have been kept honestly and efficiently; (2) the true condition of the corporate business as expressed by the balance sheet; (3) the results from the business operations logically arranged in the form of a profit and loss statement; (4) any deductions or suggestions of importance arising from the facts discovered by the auditor in the course of his examination.

The audit report shows the true results from the operations of the business and thereby reflects with accuracy the efficiency of the management. It also supplies the most authentic possible statement of past results and present conditions and thus affords a safe basis for plans of future operations. If profits have been decreasing; if production costs have fluctuated widely; if certain departments have made abnormal showings without apparent cause, a proper audit discovers the reasons, and if faults exist, enables their correction.

An important incidental advantage of periodical audits is found in the direct and material benefits which inure to the accounting department. A competent auditor must of necessity be a past master in the science of accountancy. His examination of the records will therefore inevitably discover any defects which may exist in the methods or general system employed in the accounting department of the corporation under examination. He will, then, either in the course of his audit or in his report, suggest any changes or additions that may seem to him desirable. These suggestions, based as they are on an extended study and experience of accounting methods, are usually practical and valuable, and when put into effect, not only curtail clerical labor but also increase the accuracy and general efficiency of the system.

Also the mere knowledge that a competent and exhaustive investigation of the corporate records and accounts will be made periodically, tends directly to remove temptation and prevent dishonesty, and to maintain a high condition of efficiency in the accounting department.

In some cases the auditor is called upon to make special examinations and reports, as for instance where a corporation is to be organized to take over some existing business, or when a combination or consolidation of existing industries is to be effected. In such cases thorough and extended investigations of the corporations and properties involved are essential. Such audits frequently exhibit the results of the operations of the investigated industries for terms of years, including in their scope every phase of organization, operation and condition.

§ 197. What an Audit Comprises.

A complete audit embraces the verification of all existing assets and liabilities as of a certain date, requires that all cash receipts and disbursements for the period under review be verified, that all accounts shown in the general ledger be analysed for the term covered by the audit, and, in many cases, that inventories be taken in order to ascertain the true quantity of goods on hand and in process of manufacture. The audit may also require a verification of all open accounts receivable, statements showing the balance due as of the date of the audit being sent to each debtor, with a request that any difference be reported directly to the auditor in charge. The audit should not, however, extend to such detail as checking all items from the books of original entry to the subsidiary ledgers. This merely verifies the clerical accuracy of the bookkeeper's work, requires no special skill and is ordinarily a waste of the auditor's time.

§ 198. Character of Report.

There are two general classes of audit reports, viz., (a) the unqualified report and (b) the qualified report.

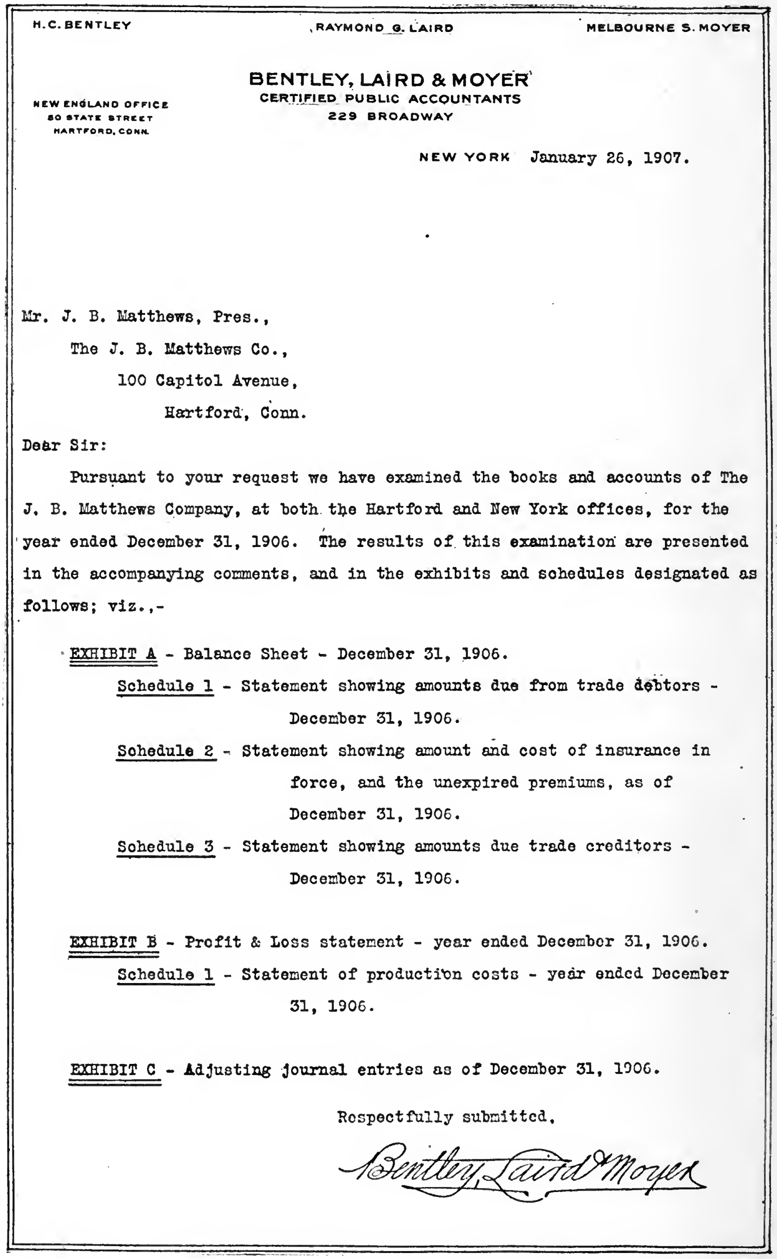
(a) *Unqualified Reports.* An unqualified report is one showing the general condition of the affairs of the business and the results of its operations, the accuracy of which is certified to without qualification or reservation by the auditor.

If an unqualified report is to be made, the accountants in charge should be permitted to verify every asset and liability. This means that they should supervise the taking of a physical inventory of all raw materials, supplies, finished products, etc.; that they should satisfy themselves as to the existence and value of all fixed assets; that they should verify all accounts receivable by sending statements to customers showing the balances due and requesting them to report any differences; that they examine all securities owned, and in short conduct such an investigation as will justify them in rendering an unqualified report.

A report full of qualifications is of little or no value, and a certificate which reads " We hereby certify that the balance sheet agrees with the books" means very little. A report is supposed to show facts, regardless of the books. If, however, it is understood by clients that only certain assets and liabilities will be examined, or that a partial audit only will be made, a qualified report follows as a matter of course and is perfectly proper.

(b) *Qualified Reports.* A qualified report is one which falls short of the unqualified report. If an audit has been made but this has not been extended to the verification of all existing assets and liabilities, it is not complete and an unqualified report cannot be made. A qualified report should show particularly in its comments what has not been done. The results themselves will show what has been done. A skeleton report (balance sheet and Profit and Loss Statement) is not a complete report. The complete report should embody comments bearing upon the items shown in the balance sheet and accompanying exhibits, so clearly stated that a person unfamiliar with the business can readily understand every detail.

§ 199. Form of Report.



H. C. BENTLEY   RAYMOND G. LAIRD   MELBOURNE S. MOYER

BENTLEY, LAIRD & MOYER
CERTIFIED PUBLIC ACCOUNTANTS
229 BROADWAY

NEW ENGLAND OFFICE
50 STATE STREET
HARTFORD, CONN.

NEW YORK January 26, 1907.

Mr. J. B. Matthews, Pres.,
The J. B. Matthews Co.,
100 Capitol Avenue,
Hartford, Conn.

Dear Sir:

Pursuant to your request we have examined the books and accounts of The J. B. Matthews Company, at both the Hartford and New York offices, for the year ended December 31, 1906. The results of this examination are presented in the accompanying comments, and in the exhibits and sohedules designated as follows; viz.,-

EXHIBIT A - Balance Sheet - December 31, 1906.

Schedule 1 - Statement showing amounts due from trade debtors - December 31, 1906.

Sohedule 2 - Statement showing amount and cost of insurance in force, and the unexpired premiums, as of December 31, 1906.

Sohedule 3 - Statement showing amounts due trade creditors - December 31, 1906.

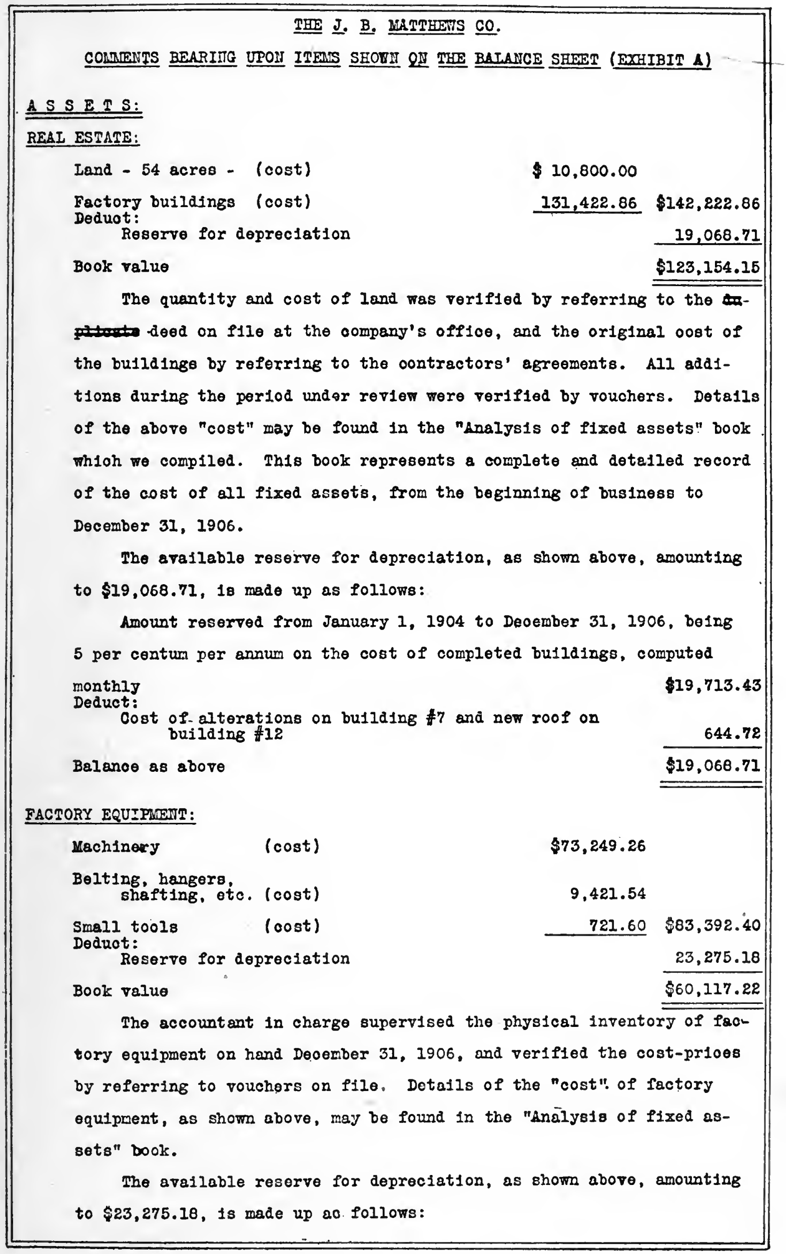
EXHIBIT B - Profit & Loss statement - year ended Decembor 31, 1906.

Schedule 1 - Statement of production costs - year ended December 31, 1906.

EXHIBIT C - Adjusting journal entries as of December 31, 1906.

Rospectfully submittcd,

Bentley, Laird & Moyer



THE J. B. MATTHEWS CO.

COMMENTS BEARING UPON ITEMS SHOWN ON THE BALANCE SHEET (EXHIBIT A)

ASSETS:

REAL ESTATE:

Land - 54 acres - (cost)	$ 10,800.00	
Factory buildings (cost)	131,422.86	$142,222.86
Deduct:		
Reserve for depreciation		19,068.71
Book value		$123,154.15

The quantity and cost of land was verified by referring to the ~~duplicate~~ deed on file at the company's office, and the original cost of the buildings by referring to the contractors' agreements. All additions during the period under review were verified by vouchers. Details of the above "cost" may be found in the "Analysis of fixed assets" book which we compiled. This book represents a complete and detailed record of the cost of all fixed assets, from the beginning of business to December 31, 1906.

The available reserve for depreciation, as shown above, amounting to $19,068.71, is made up as follows:

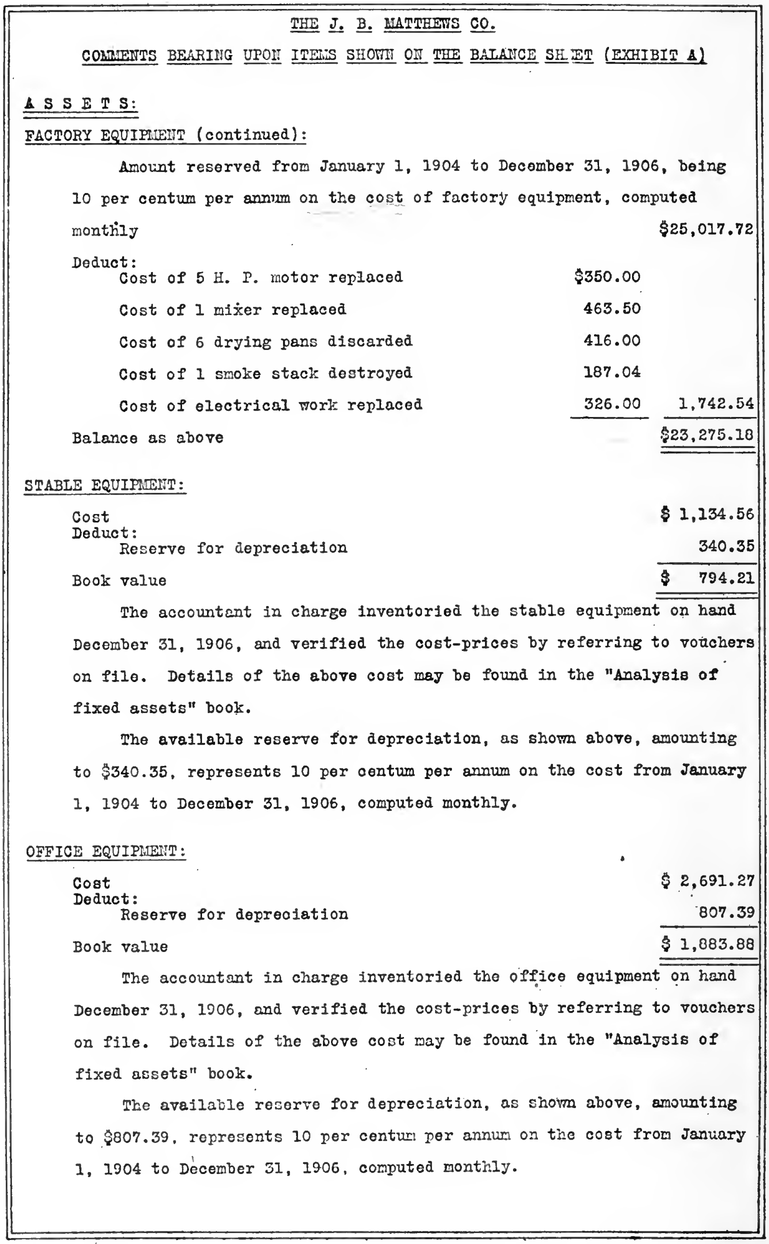
Amount reserved from January 1, 1904 to December 31, 1906, being 5 per centum per annum on the cost of completed buildings, computed monthly	$19,713.43
Deduct:	
Cost of alterations on building #7 and new roof on building #12	644.72
Balance as above	$19,068.71

FACTORY EQUIPMENT:

Machinery (cost)	$73,249.26	
Belting, hangers, shafting, etc. (cost)	9,421.54	
Small tools (cost)	721.60	$83,392.40
Deduct:		
Reserve for depreciation		23,275.18
Book value		$60,117.22

The accountant in charge supervised the physical inventory of factory equipment on hand December 31, 1906, and verified the cost-prices by referring to vouchers on file. Details of the "cost" of factory equipment, as shown above, may be found in the "Analysis of fixed assets" book.

The available reserve for depreciation, as shown above, amounting to $23,275.18, is made up as follows:



THE J. B. MATTHEWS CO.

COMMENTS BEARING UPON ITEMS SHOWN ON THE BALANCE SHEET (EXHIBIT A)

ASSETS:

FACTORY EQUIPMENT (continued):

Amount reserved from January 1, 1904 to December 31, 1906, being 10 per centum per annum on the cost of factory equipment, computed monthly		$25,017.72
Deduct:		
Cost of 5 H. P. motor replaced	$350.00	
Cost of 1 mixer replaced	463.50	
Cost of 6 drying pans discarded	416.00	
Cost of 1 smoke stack destroyed	187.04	
Cost of electrical work replaced	326.00	1,742.54
Balance as above		$23,275.18

STABLE EQUIPMENT:

Cost	$ 1,134.56
Deduct:	
Reserve for depreciation	340.35
Book value	$ 794.21

The accountant in charge inventoried the stable equipment on hand December 31, 1906, and verified the cost-prices by referring to vouchers on file. Details of the above cost may be found in the "Analysis of fixed assets" book.

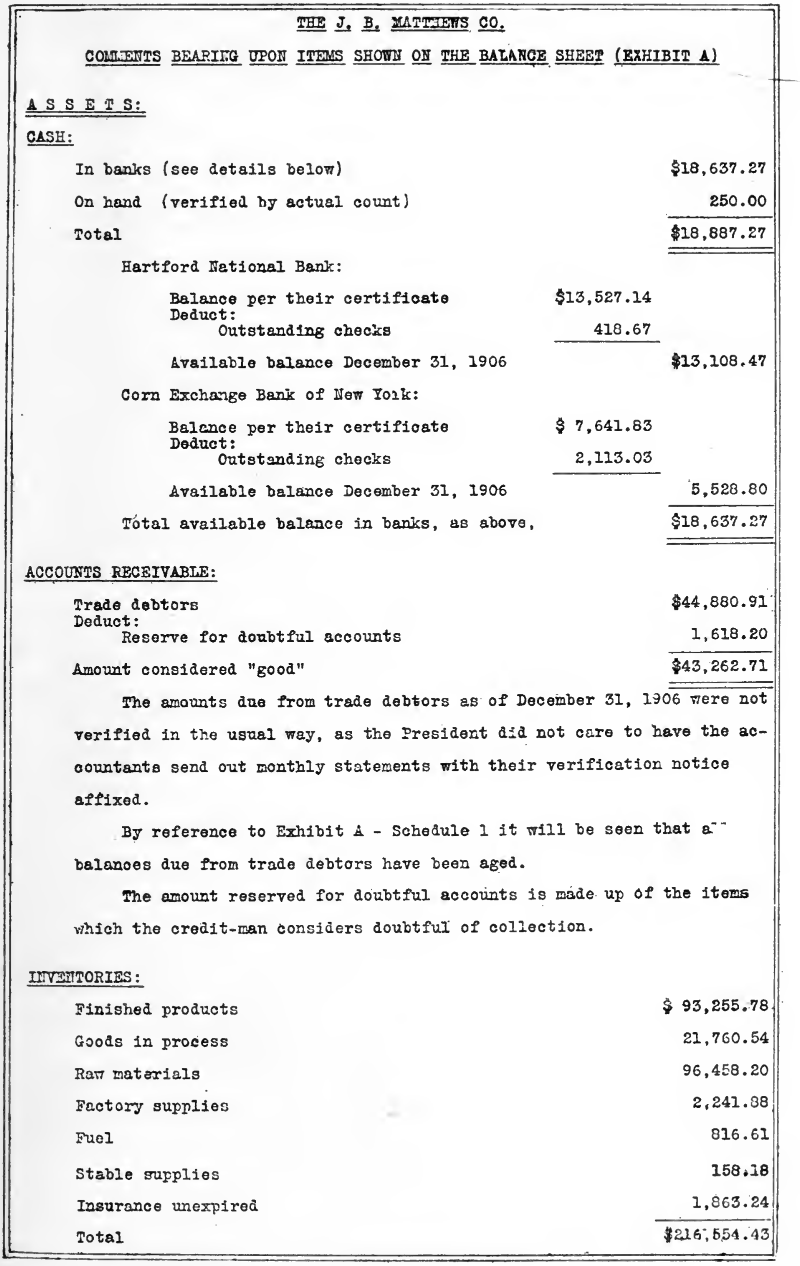
The available reserve for depreciation, as shown above, amounting to $340.35, represents 10 per centum per annum on the cost from January 1, 1904 to December 31, 1906, computed monthly.

OFFICE EQUIPMENT:

Cost	$ 2,691.27
Deduct:	
Reserve for depreciation	807.39
Book value	$ 1,883.88

The accountant in charge inventoried the office equipment on hand December 31, 1906, and verified the cost-prices by referring to vouchers on file. Details of the above cost may be found in the "Analysis of fixed assets" book.

The available reserve for depreciation, as shown above, amounting to $807.39, represents 10 per centum per annum on the cost from January 1, 1904 to December 31, 1906, computed monthly.



THE J. B. MATTHEWS CO.

COMMENTS BEARING UPON ITEMS SHOWN ON THE BALANCE SHEET (EXHIBIT A)

ASSETS:

CASH:

In banks (see details below)		$18,637.27
On hand (verified by actual count)		250.00
Total		$18,887.27
Hartford National Bank:		
Balance per their certificate	$13,527.14	
Deduct:		
Outstanding checks	418.67	
Available balance December 31, 1906		$13,108.47
Corn Exchange Bank of New York:		
Balance per their certificate	$ 7,641.83	
Deduct:		
Outstanding checks	2,113.03	
Available balance December 31, 1906		5,528.80
Total available balance in banks, as above,		$18,637.27

ACCOUNTS RECEIVABLE:

Trade debtors	$44,880.91
Deduct:	
Reserve for doubtful accounts	1,618.20
Amount considered "good"	$43,262.71

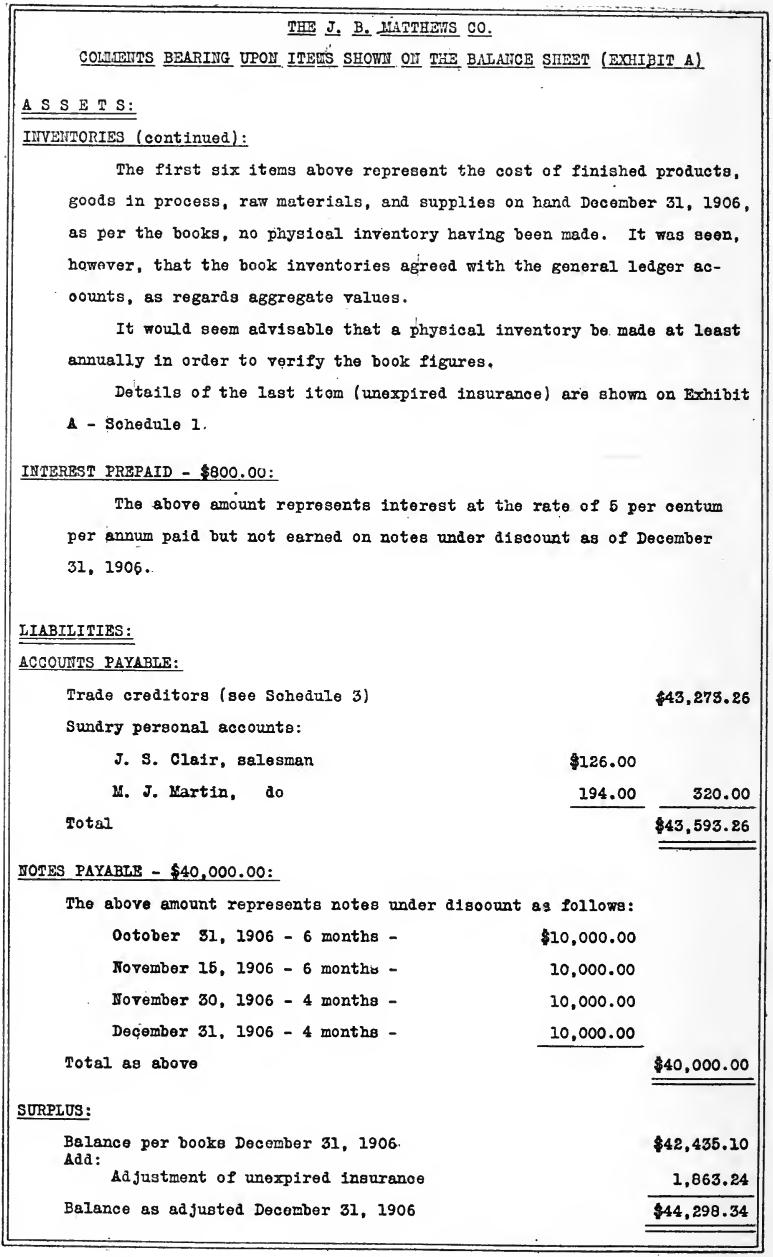
The amounts due from trade debtors as of December 31, 1906 were not verified in the usual way, as the President did not care to have the accountants send out monthly statements with their verification notice affixed.

By reference to Exhibit A - Schedule 1 it will be seen that all balances due from trade debtors have been aged.

The amount reserved for doubtful accounts is made up of the items which the credit-man considers doubtful of collection.

INVENTORIES:

Finished products	$ 93,255.78
Goods in process	21,760.54
Raw materials	96,458.20
Factory supplies	2,241.88
Fuel	816.61
Stable supplies	158.18
Insurance unexpired	1,863.24
Total	$216,554.43



THE J. B. MATTHEWS CO.

COMMENTS BEARING UPON ITEMS SHOWN ON THE BALANCE SHEET (EXHIBIT A)

ASSETS:

INVENTORIES (continued):

The first six items above represent the cost of finished products, goods in process, raw materials, and supplies on hand December 31, 1906, as per the books, no physical inventory having been made. It was seen, however, that the book inventories agreed with the general ledger accounts, as regards aggregate values.

It would seem advisable that a physical inventory be made at least annually in order to verify the book figures.

Details of the last item (unexpired insurance) are shown on Exhibit A - Schedule 1.

INTEREST PREPAID - $800.00:

The above amount represents interest at the rate of 5 per centum per annum paid but not earned on notes under discount as of December 31, 1906.

LIABILITIES:

ACCOUNTS PAYABLE:

Trade creditors (see Schedule 3)		$43,273.26
Sundry personal accounts:		
J. S. Clair, salesman	$126.00	
M. J. Martin, do	194.00	320.00
Total		$43,593.26

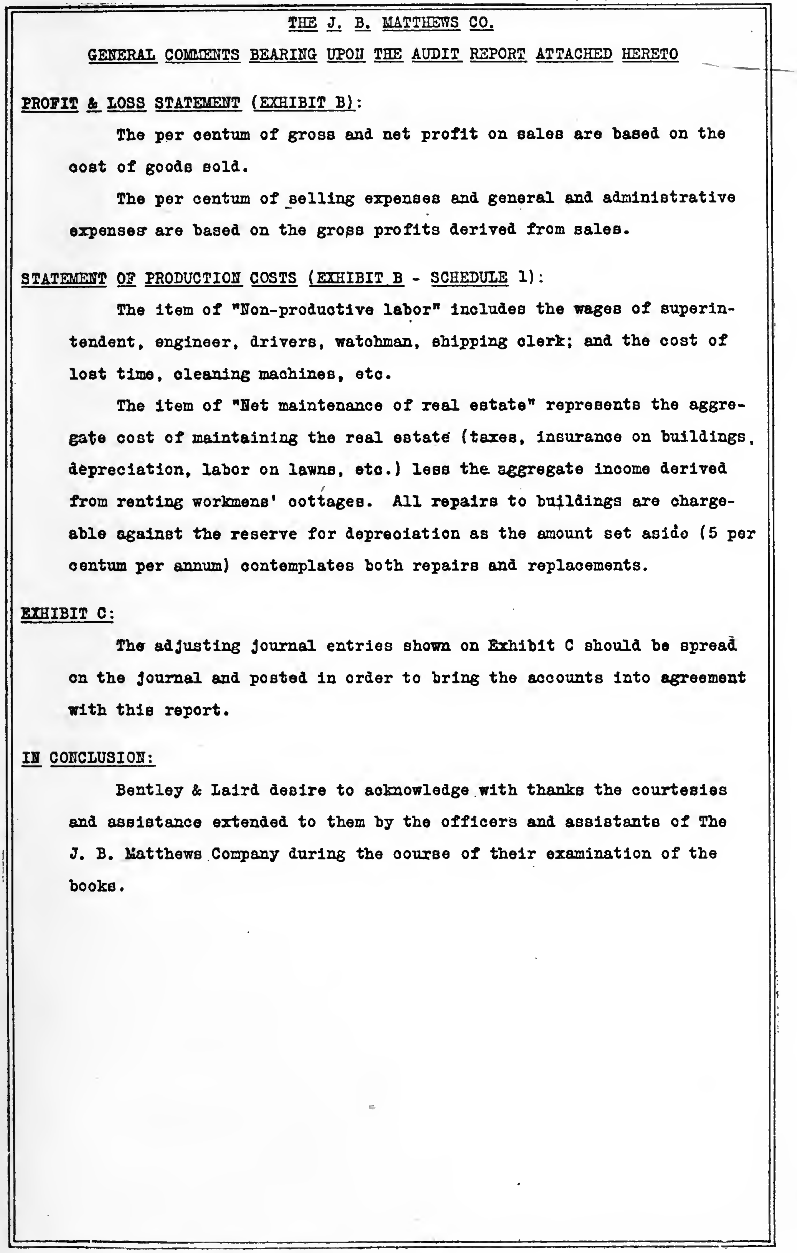
NOTES PAYABLE - $40,000.00:

The above amount represents notes under discount as follows:

October 31, 1906 - 6 months -	$10,000.00	
November 15, 1906 - 6 months -	10,000.00	
November 30, 1906 - 4 months -	10,000.00	
December 31, 1906 - 4 months -	10,000.00	
Total as above		$40,000.00

SURPLUS:

Balance per books December 31, 1906	$42,435.10
Add:	
Adjustment of unexpired insurance	1,863.24
Balance as adjusted December 31, 1906	$44,298.34



THE J. B. MATTHEWS CO.

GENERAL COMMENTS BEARING UPON THE AUDIT REPORT ATTACHED HERETO

PROFIT & LOSS STATEMENT (EXHIBIT B):

The per centum of gross and net profit on sales are based on the cost of goods sold.

The per centum of selling expenses and general and administrative expenses are based on the gross profits derived from sales.

STATEMENT OF PRODUCTION COSTS (EXHIBIT B - SCHEDULE 1):

The item of "Non-productive labor" includes the wages of superintendent, engineer, drivers, watchman, shipping clerk; and the cost of lost time, cleaning machines, etc.

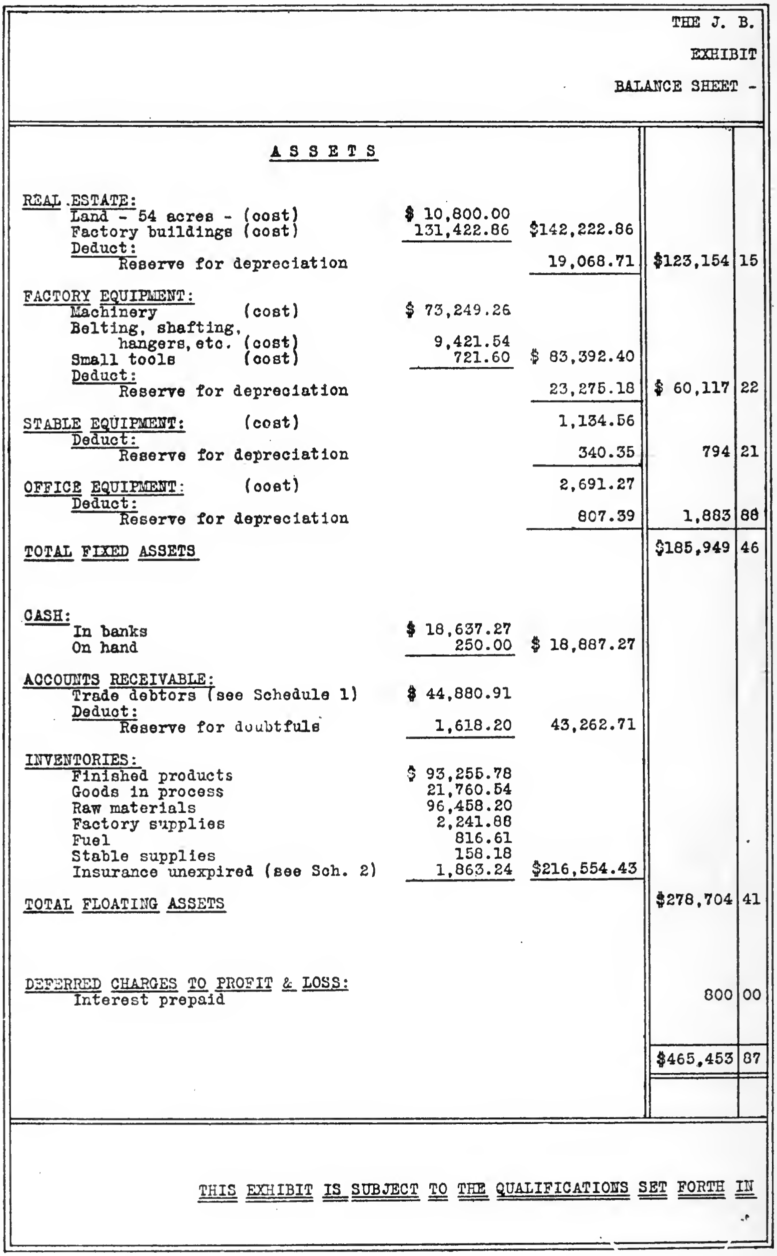
The item of "Net maintenance of real estate" represents the aggregate cost of maintaining the real estate (taxes, insurance on buildings, depreciation, labor on lawns, etc.) less the aggregate income derived from renting workmens' cottages. All repairs to buildings are chargeable against the reserve for depreciation as the amount set aside (5 per centum per annum) contemplates both repairs and replacements.

EXHIBIT C:

The adjusting journal entries shown on Exhibit C should be spread on the journal and posted in order to bring the accounts into agreement with this report.

IN CONCLUSION:

Bentley & Laird desire to acknowledge with thanks the courtesies and assistance extended to them by the officers and assistants of The J. B. Matthews Company during the course of their examination of the books.



THE J. B.

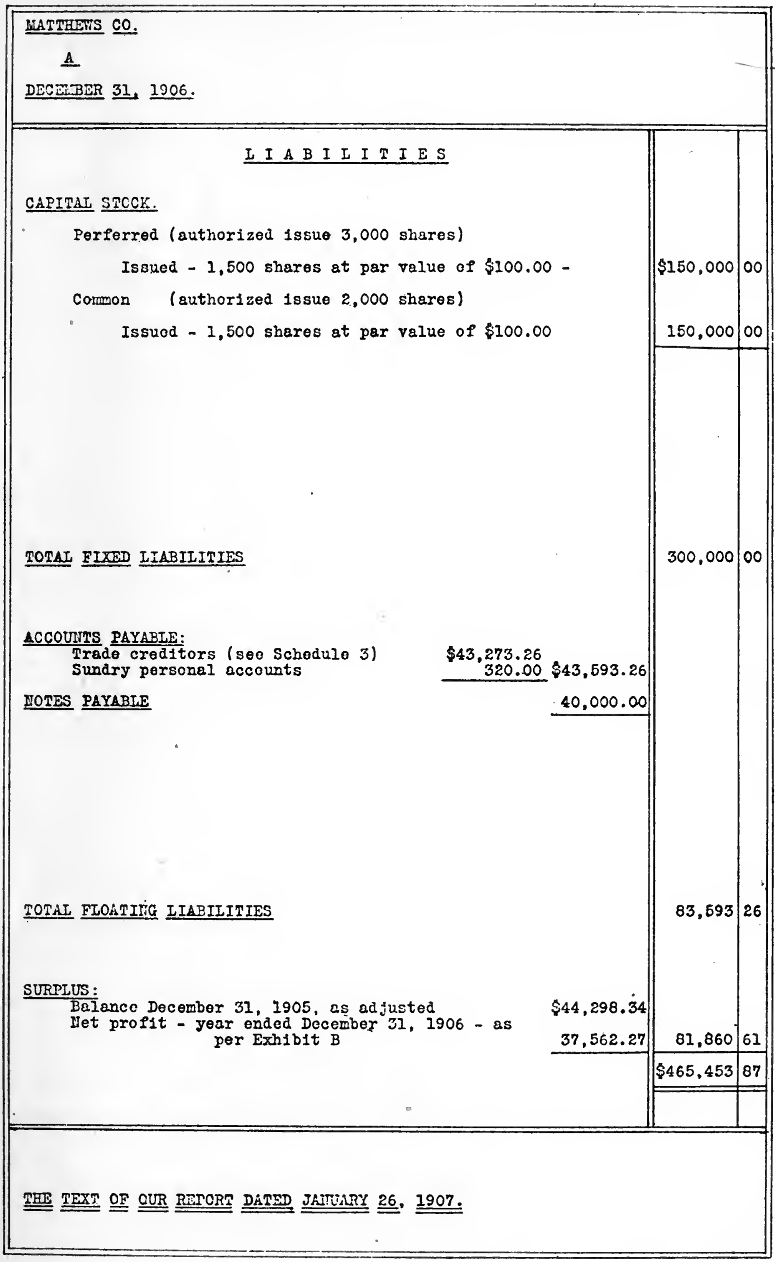
EXHIBIT

BALANCE SHEET -

ASSETS

REAL ESTATE:				
Land - 54 acres - (cost)	$ 10,800.00			
Factory buildings (cost)	131,422.86	$142,222.86		
Deduct:				
Reserve for depreciation		19,068.71	$123,154	15
FACTORY EQUIPMENT:				
Machinery (cost)	$ 73,249.26			
Belting, shafting, hangers, etc. (cost)	9,421.54			
Small tools (cost)	721.60	$ 83,392.40		
Deduct:				
Reserve for depreciation		23,275.18	$ 60,117	22
STABLE EQUIPMENT: (cost)		1,134.56		
Deduct:				
Reserve for depreciation		340.35	794	21
OFFICE EQUIPMENT: (cost)		2,691.27		
Deduct:				
Reserve for depreciation		807.39	1,883	88
TOTAL FIXED ASSETS			$185,949	46
CASH:				
In banks	$ 18,637.27			
On hand	250.00	$ 18,887.27		
ACCOUNTS RECEIVABLE:				
Trade debtors (see Schedule 1)	$ 44,880.91			
Deduct:				
Reserve for doubtfuls	1,618.20	43,262.71		
INVENTORIES:				
Finished products	$ 93,255.78			
Goods in process	21,760.54			
Raw materials	96,458.20			
Factory supplies	2,241.88			
Fuel	816.61			
Stable supplies	158.18			
Insurance unexpired (see Sch. 2)	1,863.24	$216,554.43		
TOTAL FLOATING ASSETS			$278,704	41
DEFERRED CHARGES TO PROFIT & LOSS:				
Interest prepaid			800	00
			$465,453	87

THIS EXHIBIT IS SUBJECT TO THE QUALIFICATIONS SET FORTH IN



MATTHEWS CO.

A

DECEMBER 31, 1906.

L I A B I L I T I E S				
CAPITAL STOCK.				
Perferred (authorized issue 3,000 shares)				
Issued - 1,500 shares at par value of $100.00 -			$150,000	00
Common (authorized issue 2,000 shares)				
Issuod - 1,500 shares at par value of $100.00			150,000	00
TOTAL FIXED LIABILITIES			300,000	00
ACCOUNTS PAYABLE:				
Trade creditors (see Schedule 3)	$43,273.26			
Sundry personal accounts	320.00	$43,593.26		
NOTES PAYABLE		40,000.00		
TOTAL FLOATING LIABILITIES			83,593	26
SURPLUS:				
Balance December 31, 1905, as adjusted		$44,298.34		
Net profit - year ended December 31, 1906 - as per Exhibit B		37,562.27	81,860	61
			$465,453	87

THE TEXT OF OUR REPORT DATED JANUARY 26, 1907.

THE J. B. MATTHEWS CO.

EXHIBIT A - SCHEDULE 1

STATEMENT SHOWING AMOUNTS DUE FROM TRADE DEBTORS

DECEMBER 31, 1906

	Amount		Under 30 days		Over 30 under 60 days		Over 60 under 90 days		Over 90 days	
Frick Coal Co.	$ 3,651	50	$ 729	00	$ 1,624	50	$ 1,298	00	$	
Johnson Coal Co.	2,427	28			862	31	418	20	1,146	77
West Va. C. & I. Co.	1,816	50	620	54	1,195	96				
Erie Coal Co.	3,116	00			2,327	00	789	00		
Union F. & S. Co.	941	55							941	55
Wilkes. Coal Co.	4,321	60	2,218	50	2,103	10				
Jones' Quarry Co.	260	54							260	54
Acme Quarry Co.	300	21			300	21				
Manhattan Stone Co.	118	00			118	00				
Bay State Granite Co.	8,816	22	654	26	1,218	46	6,943	50		
Four River Co.	83	60							83	60
Fuller Con. Co.	212	40			212	40				
O'Rourke Con. Co.	1,315	25			614	26	700	99		
N.Y.,N.H.& H. R.R. Co.	214	21	214	21						
N.Y.C. & H. R.R.R. Co.	376	29			376	29				
D.L. & W. R.R. Co.	484	00	262	00	222	00				
Erie R. R. Co.	111	16	81	23			29	93		
W. Shore Imp. Co.	88	40			88	40				
H. B. Joyce Co.	476	20			179	69	83	27	213	24
W. Carson Drg. Co.	316	70					316	70		
Moyer Wrecking Co.	150	40	150	40						
Smith Brothers & Co.	102	00	102	00						
City of New York	156	20			156	20				
City of Baltimore	816	90	416	90			400	00		
City of San Fran.	2,462	22	2,462	22						
Mobile Supply Co.	816	84	327	63	84	27	76	40	328	54
U. S. Steel Co.	5,321	43	2,324	63	2,996	80				
United Min. Co.	2,846	27			2,846	27				
Green Gold M. Co.	2,376	40	1,341	26			1,035	14		
Joy Prospect. Co.	384	64							384	64
TOTAL SEE EXHIBIT A	$44,880	91	$11,904	78	$17,526	12	$12,091	13	$ 3,358	88

THE J. B. MATTHEWS CO.

EXHIBIT A - SCHEDULE 2.

STATEMENT SHOWING AMOUNT AND COST OF INSURANCE IN FORCE, AND THE UNEXPIRED PREMIUMS, AS OF DECEMBER 31, 1906.

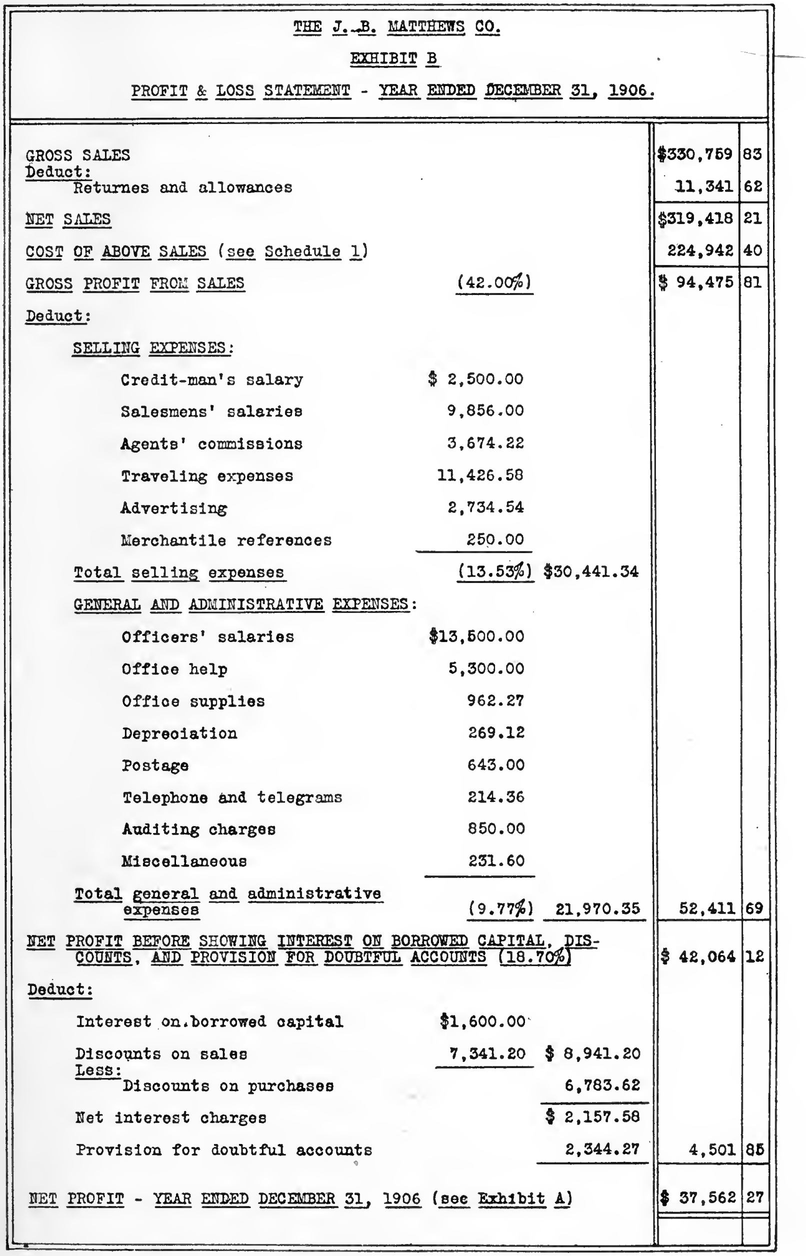
Policy -:- Number	Company	Risk	Date of Policy	Expires	Amount of Policy	Amount of Premium		Unexpired as of 12/31/06	
			1906	1907					
271346	Scottish Union	Bldgs.	Mar.27	Mar.27	$ 5,000	$ 62	50		
114616	London Assurance	do	do	do	14,000	175	00		
118264	Hartford Fire	do	do	do	6,500	81	25		
78326	Aetna - Hartford	do	do	do	15,000	187	50		
314626	American of Phil.	do	do	do	15,000	187	50		
11641	Mechanics of Erie	do	do	do	15,000	187	50	$ 668	27
216143	Phoenix - Hartford	do	Aug. 1	Aug. 1	6,000	75	00		
216248	L. L. & Globe	do	do	do	8,000	100	00		
113847	Home of Newark	do	do	do	7,500	93	75	156	80
417867	Manufacturers	Mchy.	Jul. 1	Jul. 1	14,000	175	00		
813642	Worchester Fire	do	do	do	16,000	199	50		
17816	National of N. J.	do	do	do	12,500	156	25	265	37
34621	Royal	do	Aug. 1	Aug. 1	14,000	175	00		
83261	Union of Phila.	do	do	do	8,000	100	00	114	58
9314	Connecticut	do	Oct. 1	Oct. 1	16,000	199	50		
483621	Germania	do	do	do	15,000	187	50		
83217	Royal	do	do	do	14,000	175	00	140	50
932114	Sun of New York	Stock	Jul. 1	Jul. 1	22,000	275	00		
483722	Germania	do	do	do	17,000	212	50		
342622	Phoenix - Hartford	do	do	do	16,000	200	00		
183624	Hartford Fire	do	do	do	18,000	225	00		
312004	Firemen's of Pa.	do	do	do	8,000	100	00	506	25
40706	Delaware	Stable	do	do	1,836	22	95	11	47
Amount of insurance in force - December 31/06					$284,336				
Cost of above insurance						$3,553	20		
UNEXPIRED PREMIUMS DECEMBER 31, 1906 (SEE EXHIBIT A)								$1,863	24

THE J. B. MATTHEWS CO.

EXHIBIT A - SCHEDULE 3.

STATEMENT SHOWING AMOUNTS DUE TRADE CREDITORS - DECEMBER 31, 1906.

General Chemical Co.	$18,074	26
M. Grace & Co.	7,641	43
American Fuse Co.	6,514	16
Forbes Lithographing Co.	2,860	24
Union Paper & Twine Co.	2,264	40
American Can Co.	2,164	46
Jones-Porter Co.	841	63
M. J. Stetson & Co.	816	40
Jordon Importing Co.	631	40
The Telegram	200	00
Michigan Central Railroad Co.	134	62
Erie Railroad Co.	106	20
Consolidated Gas Co.	37	46
Brown Coal Co.	35	60
City Printing Co.	29	60
American Bell Telephone Co.	25	64
Western Union Telegraph Co	14	42
Erie Lumber Co.	10	84
Hugo Janz Co.	8	61
American Trading Co.	6	43
The J. S. Miller Co.	5	46
Bentley & Laird	850	00
TOTAL (SEE EXHIBIT A)	$43,273	26



THE J. B. MATTHEWS CO.

EXHIBIT B

PROFIT & LOSS STATEMENT - YEAR ENDED DECEMBER 31, 1906.

GROSS SALES			$330,759	83
Deduct:				
Returnes and allowances			11,341	62
NET SALES			$319,418	21
COST OF ABOVE SALES (see Schedule 1)			224,942	40
GROSS PROFIT FROM SALES	(42.00%)		$ 94,475	81
Deduct:				
SELLING EXPENSES:				
Credit-man's salary	$ 2,500.00			
Salesmens' salaries	9,856.00			
Agents' commissions	3,674.22			
Traveling expenses	11,426.58			
Advertising	2,734.54			
Merchantile references	250.00			
Total selling expenses	(13.53%)	$30,441.34		
GENERAL AND ADMINISTRATIVE EXPENSES:				
Officers' salaries	$13,500.00			
Office help	5,300.00			
Office supplies	962.27			
Depreciation	269.12			
Postage	643.00			
Telephone and telegrams	214.36			
Auditing charges	850.00			
Miscellaneous	231.60			
Total general and administrative expenses	(9.77%)	21,970.35	52,411	69
NET PROFIT BEFORE SHOWING INTEREST ON BORROWED CAPITAL, DISCOUNTS, AND PROVISION FOR DOUBTFUL ACCOUNTS (18.70%)			$ 42,064	12
Deduct:				
Interest on borrowed capital	$1,600.00			
Discounts on sales	7,341.20	$ 8,941.20		
Less:				
Discounts on purchases		6,783.62		
Net interest charges		$ 2,157.58		
Provision for doubtful accounts		2,344.27	4,501	85
NET PROFIT - YEAR ENDED DECEMBER 31, 1906 (see Exhibit A)			$ 37,562	27

THE J. B.

EXHIBIT B -

STATEMENT OF PRODUCTION COSTS -

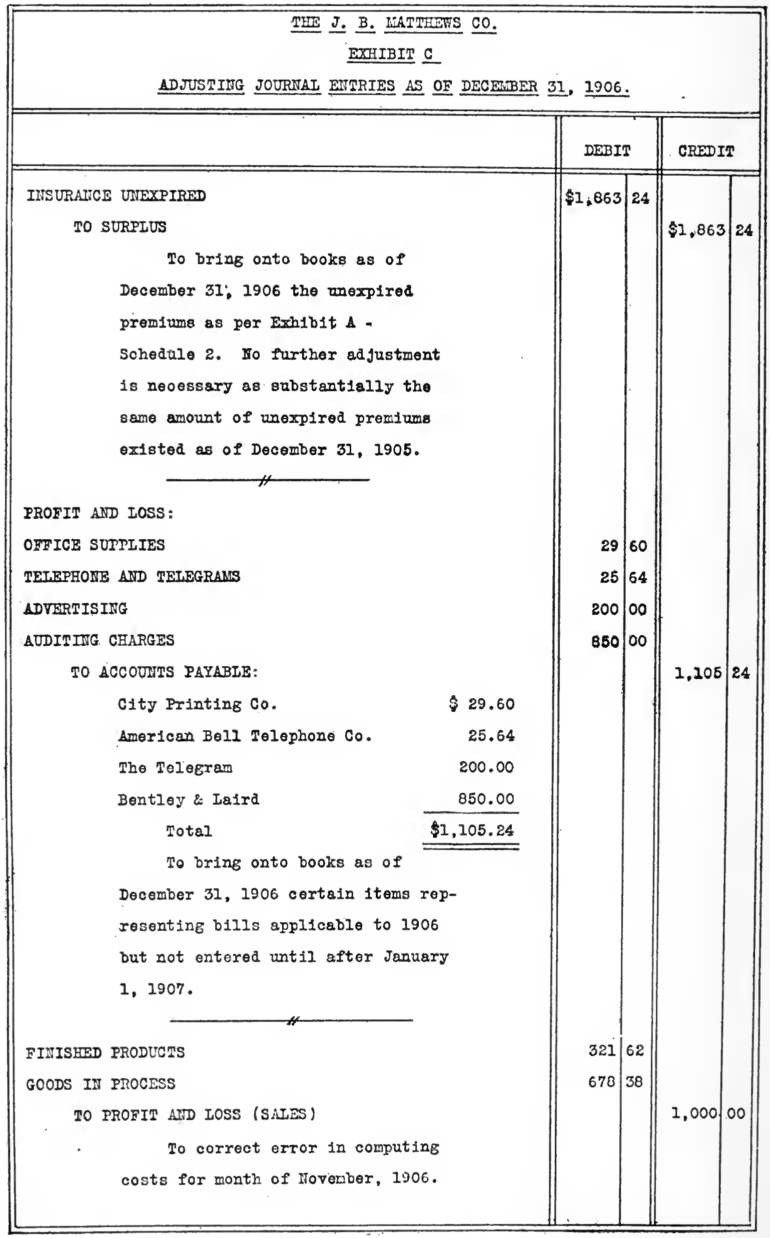
	Cost of goods in process December 31, 1905				Cost of materials, labor, and indirect charges during 1906			
RAW MATERIALS			$ 8,813	42			$150,611	81
PRODUCTIVE LABOR:								
Milling	$2,822	62			$26,318	27		
Graining	1,916	51			28,416	40		
Filling	1,142	42			26,218	41		
Capping	612	63			17,626	87		
Dipping	648	43			18,627	44		
Packing	---	--	7,142	61	21,462	27	138,669	66
INDIRECT MANUFACTURING CHARGES:								
Non-productive labor	161	43			3,641	50		
Net maintenance of R. E.	31	65			465	27		
Power, heat and light	684	28			10,623	62		
Factory supplies	309	26			3,815	65		
Taxes on equipment, etc.	162	40			1,084	00		
Insurance on equipment, etc.	193	46			2,462	26		
Depreciation of equipment	773	04			8,339	24		
Repairs to equipment	63	17			641	00		
Stable supplies	86	64			718	62		
Depreciation of H. & W.	8	43			113	45		
Misoellaneous	26	41	2,500	17	316	44	32,221	05
TOTAL COST OF GOODS IN PROCESS DECEMBER 31, 1905			$18,456	20				
TOTAL COST OF MATERIALS, LABOR, AND INDIRECT CHARGES DURING YEAR ENDED DECEMBER 31, 1906							$321,502	52
TOTAL COST OF GOODS IN PROCESS DECEMBER 31, 1906								
TOTAL COST OF PRODUCING 6,745,132 lbs.								

MATTHEWS CO.

SCHEDULE 1

YEAR ENDED DECEMBER 31, 1906.

Cost of goods in process December 31, 1906.				Cost of goods produced during 1906.				Cost per pound of finished product.	
		$11,306	24			$148,118	99		$0.022
$3,013	81			$26,127	08			$0.00387	
2,237	46			28,095	45			0.00417	
1,381	63			25,979	20			0.00385	
712	23			17,527	27			0.00259	
879	46			18,396	41			0.00272	
---	--	8,224	59	21,462	27	137,587	68	0.00319	0.0204
143	66			3,659	27			0.00054	
30	41			466	50			0.00007	
593	40			11,714	51			0.00143	
270	67			3,854	24			0.00055	
143	26			1,103	14			0.00026	
183	76			1,471	96			0.00027	
663	20			8,449	08			0.00128	
87	12			617	05			0.00012	
90	23			715	03			0.00015	
6	00			115	88			0.00003	
18	00	2,229	71	324	85	32,491	51	0.00010	0.0048
		$21,760	54						
						$318,198	18		$0.0472



THE J. B. MATTHEWS CO.

EXHIBIT C

ADJUSTING JOURNAL ENTRIES AS OF DECEMBER 31, 1906.

		DEBIT		CREDIT	
INSURANCE UNEXPIRED		$1,863	24		
TO SURPLUS				$1,863	24
To bring onto books as of December 31, 1906 the unexpired premiums as per Exhibit A - Schedule 2. No further adjustment is necessary as substantially the same amount of unexpired premiums existed as of December 31, 1905.					
PROFIT AND LOSS:					
OFFICE SUPPLIES		29	60		
TELEPHONE AND TELEGRAMS		25	64		
ADVERTISING		200	00		
AUDITING CHARGES		850	00		
TO ACCOUNTS PAYABLE:				1,105	24
City Printing Co.	$ 29.60				
American Bell Telephone Co.	25.64				
The Telegram	200.00				
Bentley & Laird	850.00				
Total	$1,105.24				
To bring onto books as of December 31, 1906 certain items representing bills applicable to 1906 but not entered until after January 1, 1907.					
FINISHED PRODUCTS		321	62		
GOODS IN PROCESS		678	38		
TO PROFIT AND LOSS (SALES)				1,000	00
To correct error in computing costs for month of November, 1906.					

The report given on the preceding pages illustrates the usual form when a complete audit is made. Fictitious names and amounts have for obvious reasons been inserted but otherwise the report is in due shape for submission.

PART III.—THE CORPORATE FINANCES.

CHAPTER XX.

THE CORPORATE FUNDS.

§ 200. General.

"Corporate funds" is a general term applied to the moneys belonging to the corporation. Technically, the term "funds" includes securities as well as moneys, but used in connection with the treasurer's work it is customary to restrict its application to cash, sight drafts, checks and similar readily convertible paper. The general corporate securities, such as notes, time drafts, treasury stock, bonds, securities of other corporations, etc., are also usually committed to the treasurer's care but not under the designation "funds," the provisions regulating the matter usually employing the phrase "money and securities," in order to avoid any uncertainty as to their scope.

§ 201. Collections.

Whether or no the treasurer is responsible for the collection of moneys due the corporation, is a matter determined entirely by the requirements or practice of the particular corporation.

In the smaller corporations collections falling due in the ordinary course of business are within the usual province of the treasurer. In the larger corporations they are not. In these all moneys as received are turned over to the treasurer, but his responsibility as to collections is limited to such special collections as may be specifically assigned to him.

§ 202. Status of Treasurer as to Corporate Funds.

In receiving and holding the corporate moneys the treasurer acts as the agent of the corporation. He must therefore safeguard them with all reasonable care, use them only on account of and for the benefit of the corporation and in accordance with its instructions. So long as he acts within these limits, he is not responsible for any losses which may occur.[1]

If, however, the treasurer fails to use reasonable care in his custody of the corporate funds, i. e., the care that a prudent man of business would exercise in regard to his own funds, he will be liable for any resulting losses. Also if he disburses, uses or invests the corporate funds without authority, he is again liable if losses result, but should gains be made, these gains belong to the corporation. In other words, any profits resulting from the use of the corporate funds while in the treasurer's care, belong to the corporation regardless of whether such use be proper or improper. If losses result from proper use of the funds, the loss is the corporation's; but if the use be improper, the loss is the treasurer's.

This same rule holds good where the treasurer privately employs corporate funds for his own benefit or account. If the transaction is discovered, the corporation can reclaim not only its funds but any resulting profits as well. If losses occur, the treasurer can be required to make these good and in addition in either case is liable to prosecution for embezzlement.

Such a condition occasionally occurs where the cashier or treasurer of an institution uses its funds for speculative purposes, expecting to replace the borrowed funds from the returns of the venture while any profits are to be retained as his

[1] First Nat. Bank v. Bank, 77 N. Y. 320 (1879).

own private gain. Usually no profits are made and the discovery of the transaction involves the defaulting treasurer in disgrace and punishment. If, however, profits should be made, these profits are the property of the corporation and if retained by the treasurer, his offense is twofold. Not only has he used and risked the corporate funds improperly, but he has stolen the resulting profits.

§ 203. Custody of Corporate Funds.

The treasurer's responsibility for the corporate funds begins as soon as they are turned over to him and continues until they are surrendered to his successor or to some other properly authorized party.

Usually the corporate authorities designate a depositary and require the treasurer to deposit the corporate funds therein. If not, it would still, as a rule, be the duty of the treasurer to deposit the moneys coming into his hands, as an incident of the " reasonable care " properly required of him.

Just how soon funds should be deposited after their receipt is a matter to be decided by conditions. Usually a routine for handling the corporate moneys and securities is established and the treasurer is governed by its rules.

In the absence of any express provision or custom requiring daily deposits, small amounts of money might properly be held until a convenient time for depositing them, particularly if there were a suitable safe or vault at the treasurer's disposal in which such funds could be kept. If, however, material amounts of money were received by the treasurer during banking hours, he would ordinarily be grossly negligent if they were not deposited the same day. If received after banking hours, they should be kept in the safest place at his command until they can be deposited on the next banking day. The temporary receptacle for such funds would naturally be the safe or vault used by the corporation for the preservation of its books, papers and other valuables. Should the treasurer place his funds elsewhere, a very clear and satisfactory explanation of his reasons for so doing would be necessary to save him from liability in case of any resulting loss.

In the larger or more active corporations considerable amounts of money are often kept over from day to day in the various funds, or for special purposes, but they are kept under such conditions of safety as to render the risk negligible. Also as this is done with intent, and with the knowledge and consent of all parties concerned, the treasurer is not liable even though losses occur.

The general rule that the corporate funds should be deposited promptly applies particularly in the case of checks. The check is merely an order for money and if the treasurer accepts this order and does not present it promptly for payment, he is himself liable for any loss occasioned by the delay.[2]

§ 204. Disbursement of Corporate Funds.

The disbursement of the corporate funds is usually made under carefully prescribed conditions, and the treasurer can hardly incur liability in the exercise of this duty save as a result of gross negligence or downright fraud.

Usually the by-laws provide generally that the corporate funds shall be paid out by the treasurer in accordance with the instructions of the directors, and also prescribe the exact signature to the checks by means of which payments are made, and require that the treasurer shall take all proper receipts and vouchers. If the by-laws are silent, the directors have full power to make such rules as to disbursements as they deem proper.

If neither by-laws nor directors' resolutions make any provision as to the details of disbursements, the treasurer may then use his discretion and need only observe the rules of ordinary business. These would undoubtedly require that pay-

[2] Smith v. Miller, 43 N. Y. 176 (1870); First Natl. Bank v. Bank, 77 N. Y. 320 (1879); See §§ 47, 224, 228, *infra*.

ments of importance be made by check whenever reasonably possible, and that receipts or vouchers be taken for all moneys paid out.

In no event has the treasurer authority to make payments on his own initiative. The matter is one that belongs to the directors alone and the treasurer has no right either to make a payment without their authorization or to refuse a payment when it has been directed by them.

The payments of corporate funds customarily made by the treasurer in practice without specific authorization are not in violation of this rule. Occasionally he will in an emergency or for special reasons, pay accounts without authorization of any kind, but he then relies upon the acquiescence or express ratification of the directors.[3] Usually, however, his payments when not specifically authorized, are made under blanket instructions empowering the payment of large amounts made up of numerous small items. Or perhaps, certain routine obligations as the pay roll at the end of each week, will be paid as a matter of course under the implied authority of custom.

The treasurer's responsibility for the correctness and validity of accounts paid, depends upon the conditions. If bills are ordered paid by the directors the treasurer ordinarily has no responsibility in the matter save for their proper payment, unless he is aware of doubtful or fraudulent circumstances connected with these accounts not known to the directors. If, however, under a general authorization he pays accounts which later prove to be false or fraudulent, he might be held for any resulting loss. To escape it he must show that he was unaware of and could not have been reasonably expected to discover the fraudulent nature of the accounts.[4]

[3] See §§ 9, 21.

[4] See Chap. VII, "The Treasurer's Liabilities"; also § 213.

§ 205. Return of Corporate Funds.

At the conclusion of the treasurer's tenure of office, it is his duty to return the corporate funds to his successor or to such other party as may be designated by the board of directors. If he does not do this voluntarily, their return may be enforced by legal action.[5] If any deficiencies are discovered in the funds, the treasurer or his bondsmen must make them good, and if such deficiencies occurred through the treasurer's wrong doings, he is liable to a criminal action.[6]

[5] Hunter v. Robbins, 117 Fed. Rep. 920 (1902); Consolidated, etc. Works v. Brew., 112 Wis. 610 (1902).

[6] See §§ 12, 19.

CHAPTER XXI.

BANK DEPOSITS.

§ 206. Selection of Depositary.

The designation of the corporate depositary may be made by the charter, the by-laws or the directors, or it may be left to the treasurer of the corporation. It is manifest, however, that the selection should ordinarily be entrusted to the directors. The matter is too important to be left to the treasurer's unrestrained discretion. The charter and by-laws are too difficult of change to render them a suitable medium. The directors, on the other hand, combine a discretion and responsibility with a reasonable promptness of action, that clearly fit them for this duty.

§ 207. Directors' Powers as to Depositary.

(a) *When Designated by Higher Authorities.* If the particular bank in which the corporate deposits are to be made is designated in the by-laws, the directors have ordinarily no power to change this designation. Emergencies might, however, arise which would modify this general rule.

Thus, should some unforeseen crisis endanger the solvency of the designated bank and it be impossible to secure another by-law designation with promptness, the directors would then not only be justified in transferring the corporate funds to some more secure depositary, but must do so in the proper discharge of their duties. They are directly responsible for the safety of the corporate property and must take all reasonable measures to conserve this. Also they are entitled to exercise their discretion as to what is reasonable and necessary, and, provided only that the emergency was real and their discretion honestly exercised, the directors could not be held liable for the results of their action, nor could the treasurer be held to account for obeying their instructions, even though they were in temporary disregard of the higher corporate authorities.[1]

(b) *Designation by Directors.* The selection of the corporate depositary may be left to the directors, either by express charter or by-law provisions, or by the absence of any charter or by-law provisions which would prevent their exercise of the power. In either case they have authority to act and have wide discretion. They must exercise reasonable care —such care as a prudent business man would employ in selecting a depositary for his own funds—but beyond this they may designate any such bank, national, state or private, or such trust company as may seem to them most suitable or most advantageous for the corporation.

§ 208. Treasurer's Powers as to Depositary.

(a) *When Designated by Higher Authority.* When the by-laws or directors' resolutions designate the corporate depositary, the treasurer must govern himself accordingly. Should he, in disregard or defiance of the designation of the higher authority, deposit the corporate funds elsewhere, he would be liable to the corporation for any resulting loss and would also be subject to removal from office for disobedience of the corporate authorities.[2]

The treasurer might, however, under some circumstances have discretionary power. "Although the powers of agents

[1] Greenleaf v. Moody, 13 Allen (Mass.) 363 (1866); Story on Agency, § 141.

[2] See § 49.

are, ordinarily, limited to particular acts, yet extraordinary emergencies may arise in which a person who is an agent, may, from the very necessities of the case, be justified in assuming extraordinary powers; and his acts when fairly done under such circumstances will be binding on his principal."[3]

For instance, if information convinces the treasurer that the designated bank is unsafe, and the emergency is too pressing to await board action, he might withhold any corporate funds on hand, and, if the conditions permit, withdraw the funds already deposited. Also he might deposit the funds so withheld or withdrawn, in some other bank until their more permanent disposition could be determined by the directors.

The treasurer's discretion in such matters is, however, entirely temporary, not to be called into play at all if action by the board can be safely awaited, and in any case lasting only until the board can convene and take such action as the emergency demands. To avoid risk to himself, he would also usually act only after conference with and the approval of any individual directors or other officers of the company who might be accessible.

(b) *Designation by Treasurer.* If the higher corporate authorities neglect to designate a depositary for the corporate funds, the treasurer may then himself select a suitable depositary as an incident of the proper discharge of his duties.

Should the treasurer fail to do so and loss ensue, he must either show that it was impossible or inexpedient that the funds should be deposited in the usual manner, or otherwise be held liable for lack of due care and diligence in the performance of his duties.

§ 209. Status of the Corporate Depositary.

When the corporate account is opened, the bank may by special arrangement be made either an agent or a trustee for the corporation in its care of the corporate funds. If, however,

[3] Story on Agency, § 141.

this is not done, the corporate funds are received by the bank on "general deposit" and the bank is then neither agent nor trustee, but merely a debtor of the corporation for the amount deposited. It holds the corporate funds exactly as it would borrowed money, and its duties, powers and liabilities are in effect the same. Practically the deposit is an unsecured demand loan, drawing no interest, unless otherwise agreed. As a debtor of the corporation the bank may charge or offset any amounts due from the corporation to it against the corporate deposit.

The funds deposited by the corporation must be returned to it when demanded and as demanded, but this is the extent of the corporation's control of its deposited funds. The bank, on the other hand, must be prepared to meet all demands for payment of deposited funds, but beyond this may use them as freely as it would its own. If the bank wishes to invest the corporate funds on deposit, it may do so and if profits result, these profits belong to the bank. Conversely, if losses are incurred, these also belong to the bank. If, however, the losses of the bank should be so great as to render it insolvent, the corporation takes its place with the other creditors and must realize what it can from the liquidation of the bank assets.

§ 210. Opening the Account.

When, as is usual, the selection of the corporate depositary is left to the board of directors, the designating resolution will vary in its details according to the conditions.

For the smaller corporations such a resolution should empower the treasurer to open the account with the designated institution, deposit the corporate funds therein and withdraw them on checks with specified signature. It might also properly state his authority to endorse checks, drafts and notes for deposit or collection, as the case may be. This leaves any special transactions with the bank, such as a loan or discount, to be provided for by special action of the directors.

In the larger corporations the treasurer, either alone or in connection with the president, is usually given much more extensive powers, including the discounting of notes and drafts and the right to make loans and to deposit collateral to secure these loans, and these powers also usually appear in the designating resolution. (See Form 18.)

The bank officials naturally prefer these wider powers. They practically give the corporate officials unrestricted authority as to all matters concerning the bank. The necessity for special authorization of the corporate officials when some bank transaction out of the ordinary is undertaken, is thereby removed and the bank officials are also relieved from all enquiry as to the authority of the corporate officials for contemplated transactions with the bank.

For these reasons the printed resolutions prepared by the banks for the use of corporations opening accounts, generally give wide and unrestricted powers. The banks always prefer and sometimes insist that the corporation shall employ these resolutions, not alone on account of the extended powers conveyed but because they are in the form to which the bank is accustomed.

The directors should employ the resolutions of the bank if they are compatible with the limits of the powers to be conferred upon the corporate officials and if they are acceptable in other respects, but if this is not the case, the unintended or objectionable powers or provisions should be stricken out before the resolutions are adopted. This still leaves the resolutions in the general form preferred by the bank, but as to their subject matter in accordance with the wishes of the directors.

The authorizing resolutions of the directors almost always contain provisions as to signatures to checks, powers of endorsement, etc., which already appear in and are fixed by the by-laws. This repetition is not objectionable, neither strengthening nor detracting from the by-law provisions. Its only purpose is, as a matter of convenience, to bring together all matters pertaining to the bank account.

When the corporate account is to be opened, the bank will require evidence of the treasurer's authority and a statement of the conditions under which it is opened. To supply this, it is customary for the directors' authorizing resolution, together with the names, official positions and signatures of the officers appointed to sign and countersign the corporate checks, to be certified by the secretary of the corporation under the corporate seal.[4] The bank may also require a copy of any by-law provisions relating to deposits or in some cases a full copy of the by-laws and these must likewise be certified. Occasionally the banks require notarial acknowledgments in addition to the secretary's certificate.

When the treasurer's authority and the conditions under which the corporate account is opened are thus duly certified, and the certified instruments have been filed with the bank, and when any other required formalities are complied with, the treasurer turns over such funds as he may have on hand, for deposit, receives the corporate pass book and the opening of the account is complete.

By agreement between the corporation and the bank, the corporate funds might be deposited on "special deposit," instead of on "general deposit" as is usually the case, and they are then held subject to the agreed terms. Thus the deposit might not be subject to withdrawal for a certain term, or only after specified notice. Any of the agreements of special deposits modify the law as applied to general deposits and sometimes change entirely the relation of debtor and creditor usually existing between the depositor and the bank.

§ 211. Corporate Deposit in Treasurer's Name.

Corporate accounts are sometimes opened in the name of the treasurer. The practice, as has been stated, is a bad one, the objection to it being twofold:—

[4] See Form 21.

(1) The treasurer has the disbursement of the corporate funds entirely in his own hands. He may withdraw them for proper or improper purposes at his pleasure. Also he can refuse to make duly authorized payments if he is so disposed and the corporation will then have much difficulty in forcing such payments and in securing proper control of its own funds.

(2) In case of the disability, death, resignation or removal of the treasurer, or the expiration of his term of office, the procedure to secure possession of the corporate funds may likewise be difficult.

If the funds are in the name of the corporation, the whole matter in case of a change in the treasurership is settled by the mere delivery to the bank of a duly executed certificate setting forth the appointment of the new treasurer, and containing a copy of his signature as it is to appear on the corporate checks. When, however, the funds are deposited in the treasurer's name and a new treasurer is appointed, a transferring check must be secured from the old treasurer, or else the corporation must formally prove its ownership of the funds and its right to their withdrawal, and in either case a new deposit must then be opened by the new treasurer. In the one case nothing more than a simple matter of routine corporate procedure is necessary to effect the transfer. In the other case formal and somewhat difficult action is always required, and legal proceedings may become necessary.

Also the treasurer himself should, as a matter of business prudence, object to the opening of the corporate account in his own name as he is thereby rendered personally liable for any loss of these deposited funds which may result through the failure of the bank, or from other causes. The rule on this point is very explicit. "In case it becomes the duty of an agent or trustee to deposit money belonging to his principal, he can escape the risk only by making the deposit in his principal's name, or by so distinguishing it on the books of the bank as to indicate in some way, that it is the principal's money. If he deposit it in his own name he will not, in case of loss, be permitted to throw such loss on his principal."[5]

§ 212. Deposit of Funds.

Corporate funds coming into the treasurer's hands should be deposited at the first opportunity. If the treasurer delays a deposit unduly, he will be liable for any resulting loss. On the other hand, as soon as the funds have been duly deposited he is relieved of liability therefor and the burden of responsibility is shifted to the bank. It is ordinarily, therefore, not only good business policy but to the direct interest of the treasurer that the corporate funds should be deposited as soon as they are received.

As to what constitutes such reasonable promptness in making deposits as will relieve the treasurer from responsibility, it may be said that when large sums are received, and particularly when in the form of checks, they should be deposited the same day, or, if received after banking hours, on the day following at the latest. In the larger corporations where deposits are made daily, the question will not arise as neither cash nor checks are ordinarily held longer than one day. In the smaller corporations when deposits are not made every day, moneys coming in might properly be held until the time for the regular deposit unless their amount were large or other conditions made an earlier deposit desirable.[6] As to what constitutes due promptness in depositing checks, see § 228 of the present volume.

Deposits of the corporate funds are usually made with the receiving teller. They might, however, be safely made with any other officer of the bank apparently authorized thereto, if made within the bank and during banking hours. They should not, however, be made outside the bank, or outside of banking

[5] Naltner et al v. Dolan et al, 108 Ind. 500 (1886); Williams, Admr. v. Williams, 55 Wis. 300 (1882); Greenfield School Dist. v. Bank, 102 Mass. 174 (1869); Booth v. Dexter, etc. Co., 118 Ala. 369 (1897).

[6] See § 203.

hours, unless the depositor knows that the receiving officer has been fully authorized to receive deposits in this irregular way and is acting with the knowledge and concurrence of the bank.

The treasurer's pass book, showing by proper entry that the corporate funds have been deposited, is all sufficient evidence of both the deposit and the bank's liability therefor.

As a rule, when a bank of deposit fails, all funds on general deposit are involved and are tied up until some general settlement is made. An exception may arise as to a deposit made the day of the failure, which may or may not be recovered intact according to the circumstances.

If such deposit were received in good faith by the bank officials who were unaware of the impending insolvency of their institution, the deposit would take its place as part of the general funds of the bank subject to such settlement as the insolvent institution may be able to make. If, however, it can be proved that the officials received the deposit when they knew of the impending insolvency of the bank, and the funds so deposited can be traced into the hands of the receiver or assignee of the bank, they may be recovered intact.

If actual cash were deposited, it is always difficult and generally impossible to meet these requirements. If, however, the deposit consisted in whole or in part of checks, these checks, if not already collected, may usually be traced and recovered.[7]

§ 213. Withdrawal of Deposit.

The withdrawal of the corporate funds when once deposited must be effected by means of written orders, i. e., checks.

When a check properly drawn on funds deposited in the bank is presented, the bank must pay the check, and if it does not do so, the corporation may bring suit not only to enforce payment of its check but for damages as well if damages can

[7] Quin v. Earle, 95 Fed. Rep. 728 (1899).

be shown. Damages would usually be confined to the injury to the credit of the corporation.

The corporate deposit, unless otherwise specially agreed between the corporation and the bank, may be repaid in current funds of any kind at the discretion of the bank. Thus the corporation may have deposited gold but the bank, if it sees fit, may repay the amount in greenbacks or bank notes. This is merely an incident of the relation of debtor and creditor, existing between the bank and the depositor corporation.

The actual form of the check by which withdrawals of the corporate deposit are made, is immaterial, provided it is clear and unmistakable in its terms. The details of the form are generally left to the treasurer, except as to the signature, which is usually and properly prescribed by the by-laws or by the board of directors. As a matter of safety, the signature should include two names,—the corporate name signed by the treasurer, and a countersignature or direct signature affixed by some other of the corporate officials.[8]

All withdrawals of the corporate funds may be stopped by the corporation at any time by mere notice to the bank. Occasionally they are stopped by other parties by legal proceedings. For instance, some party having a claim against the corporation may attach its funds in the bank, or they might be garnisheed by some employee of the corporation. In either of these cases the corporate funds would be effectually tied up and the bank could not pay the corporate checks thereafter except at its own risk, until the attachment or garnishment was dissolved.

It may be noted in passing that the treasurer must obey the instructions of the directors implicitly in regard to disbursements of the corporate funds. He has no discretion in the matter even though he deems payments unwise or suspects them of being absolutely fraudulent. If he were in doubt as to any particular payment, he might suspend action until he

[8] See Chaps. XXII and XXIII, "Checks;" also Chap. XXXIII.

could receive further instructions from the board, but that would be the extent of his powers.[9]

In any case where the treasurer refuses to obey the instructions of the board as to disbursements, the board might, if necessary, force him to sign the proper checks or vouchers by legal action. The question is, however, one that seldom arises. Usually in case of disobedience on the part of the treasurer, the board merely removes the offender and proceeds to the election of a new and more amenable official.

[9] See § 204.

CHAPTER XXII.

CHECKS.

§ 214. General.

The funds of a corporation are usually received in the form of checks. After these funds are deposited, checks are again employed in their disbursement. As the receipt, care and disbursement of the corporate funds are the best recognized duties of the treasurer and as a knowledge of the law and procedure governing the use of checks is essential to the proper discharge of these duties, the subject is treated with some fulness in the present volume; also, on account of its close connection with the corporate finances, it is treated here rather than in the portion of the present work more particularly devoted to negotiable instruments.[1]

§ 215. Nature.

As stated in the preceding chapter, a bank deposit represents money due from the bank to the depositor. A check is the depositor's written order on his bank calling for the payment of a designated portion of this money to some specified party or to the order of this party, or perhaps to bearer. The order is due and payable on demand unless otherwise specified on its face or indicated by a post-date.

A check, though properly drawn and delivered, is not money and is not a legal tender, nor does it, save in a few

[1] See Part IV.

states, act as an absolute assignment of the specified amount of the depositor's funds to the party in whose favor it is drawn. Neither is it ordinarily a good payment until it has actually been collected.[2] It is merely an order on the bank to pay on demand to the party designated, such amount of the drawer's funds as are called for by the check, and this order is revocable by the maker at any time prior to its actual payment.[3]

In a few States—Nebraska, South Carolina, Texas—however, it is held that the delivery of a check carries the actual ownership of its face amount of the depositor's funds and a check, if properly drawn against sufficient funds and accepted by the creditor, is a good payment, and such check cannot thereafter be revoked by the maker.

A check closely resembles a draft or bill of exchange, particularly if the check is post-dated. This is recognized by the Negotiable Instruments Law[4] which defines a check as "a bill of exchange drawn on a bank, payable on demand." The main points of difference between the two are as follows: (1) Checks are always drawn upon a bank or banker, whereas a draft may or may not be so drawn. (2) Checks, unless post-dated, are payable upon presentation, whereas drafts are usually payable a certain number of days after presentation. (3) Checks are never presentable for mere acceptance but only for payment, whereas drafts are usually presented for acceptance and are payable on a later date. (4) The check never carries days of grace, whereas the draft, in some states, does. It may also be said that the wording of the draft is usually somewhat different from that of the check. The certification of a check differs in its legal effect from the acceptance of a draft. (See § 231.)

[2] Florence Mining Co. v. Brown, 124 U. S. 385 (1888); Bradford v. Fox, 38 N. Y. 289 (1866); Carroll v. Sweet, 128 N. Y. 19 (1891); see § 227.

[3] German N. Bank v. Farmers' Bank, 118 Pa. St. 294 (1888).

[4] New York, § 321.

§ 216. Form.

The general form of a check is of but little importance. It must contain certain essential features (See § 217) and these must appear with reasonable clearness, but they may be arranged to suit the taste, or the convenience of the parties interested. In practice, checks vary as to shape, style, arrangement and, within narrow limits, as to matter.

A bank has no legal power to insist upon or refuse any special form of check. It might be justified in refusing payment of a check so arranged as to be obscure in some essential feature but, speaking generally, it is bound to pay any check properly drawn upon it, no matter what the form. It may, however, always refuse to receive or to continue a deposit if the depositor does not conform to its requirements and in this way may guard against checks of undesirable form or arrangement.

§ 217. Essential Features.

A check must show:—

(a) Its date.

(b) The amount to be paid.

(c) The drawer, i. e., the party by whom the check is drawn.

(d) The drawee, i. e., the bank, banks or trust company upon which it is drawn.

(e) The payee, or party in whose favor the check is drawn.

Every check must contain these essential features.[5] If any of them are lacking, the instrument is incomplete and the bank is under no obligation to honor it. Additional matter may be inserted if desired, but it must not interfere with or modify the essential features, or the check again becomes de-

[5] See § 262.

fective. The essential features of the check are discussed in the sections which follow.

§ 218. (a) Date.

The check is payable on or after, but not before, the day on which its maker intended it to be paid as shown by its date. If the date is omitted, the intention of the maker as to time of payment is not indicated and the bank may, if it chooses, refuse the check.

In case the date is omitted, the holder of the check has by implication a well recognized authority to insert the missing date and thereby complete the check, and the bank, in the absence of any suspicious circumstances surrounding the insertion of the date, must be governed thereby and pay the check on presentation at any time thereafter.

As a matter of practice, when a check undated but otherwise properly drawn, is presented for payment, the paying bank usually inserts the current date and honors the check. It runs no risk in so doing. The payee benefits by the act, impliedly authorizes it and is therefore estopped from objection. Neither can the drawer object, even though he intended to post-date the check so that it should be paid at some future time. In omitting the date of his check, he has been negligent and he must himself bear any resulting loss or inconvenience.

If, however, a check has been properly dated by the drawer and this date is changed later, a very different rule applies. A change of date is held to be a material alteration of a check[6] and therefore renders it void or voidable and the bank upon which it is drawn is liable in case it pays the altered check, for any loss resulting from such payment.[7]

It is well established that a post-dated check—that is, a check dated later than the day on which it is drawn—is not payable until its date is reached. Thus a check drawn on the

[6] See §§ 237, 273.

[7] Crawford v. Westside Bank, 100 N. Y. 50 (1885).

first of October but dated the twentieth of October, is not payable until the twentieth of that month, and if the bank should either intentionally or inadvertently pay the check before that date, it does so at its own risk.

It not infrequently happens that post-dated checks are paid before their due date is reached, usually through inadvertence on the part of the drawee bank. In such case the drawer may possibly never discover the too early payment of his check, or he may discover it but not be involved in any loss thereby. In either of these cases the bank escapes without loss to itself.

If, however, before the real due date of the check the drawer revokes it as he has full power to do, and notifies the bank to stop payment, or if he suffers any loss from the bank's prepayment, the bank is liable. Not having complied with the terms of the drawer's check, it must itself bear any loss which may result.[8]

The antedating of a check is rare and has no special effect as between the parties to the check. Apparently the check was drawn at an earlier date than is really the case but as a check is not due until presented for payment, this does not give it precedence at the bank in any way, or give the payee any claims or rights on the drawer's funds in the bank that he would not have had under a check correctly dated. Such checks are, however, occasionally given for ulterior purposes, usually of doubtful propriety.

§ 219. (b) **Amount.**

A check must be drawn for a certain fixed amount of money. As a matter of practice, the amount of a check is usually expressed in both words and figures. If there is a difference between the written amount and the amount expressed in figures, the written amount will prevail.[9] It is sup-

[8] Frazier v. Bookbinding Co., 24 Hun 281 (1881); S. C. Affirmed, 90 N. Y. 678 (1882); Clark N. Bank v. Bank, 52 Barb. 592 (1868).

[9] Daniel on Neg. Inst., § 86; Smith v. Smith, 1 R. I. 398 (1850); see § 268.

posed to express the deliberate intent of the drawer, the figures merely supplying corroborative evidence of its correctness.

When the amount is written in both words and figures, the figures are entered in such wise as to indicate their subordination—usually on the margin or corner of the check. A check may, however, be drawn with the amount expressed in figures only, or expressed in words only and the general requirements of the law are complied with. The drawer's instructions must be expressed clearly and unmistakably but this may be done either by the use of figures or by the use of words. Hence if the amount is expressed in words alone, placed in the usual position, or in figures alone, these being placed in the position usually occupied by the written amount, the check is not ambiguous and must be paid if legally correct in its other essential features.[10]

If the amount of a check is left blank, the holder may insert it in accordance with the maker's intent, but cannot insert a larger amount.[11]

§ 220. (c) **Drawer.**

As a check is an order for money, the drawer must have funds on deposit to meet this check when presented. To draw a check on a bank in which the drawer has no deposit, is ordinarily a criminal offense. To give a check on his own bank at a time when his funds were exhausted, would not be a criminal act on the part of the drawer unless the check were drawn with fraudulent intent.

The drawer of a check cannot, however, be held liable in any way for drawing a check, whether or no it is drawn against a deposit, if at the time it is presented he has sufficient funds in the drawee bank for its payment.

Thus the purchaser of goods may pay for them by check on a bank in which he has no deposit, or in which his deposit

[10] National Bank v. Bank, 69 Ind. 479 (1880).

[11] See § 269.

is exhausted. If in the one case he opens a deposit, or in the second deposits funds to his credit, sufficient to meet the check before it is presented for payment, the transaction will be held legitimate and no action can be maintained against the drawer of the check. Or a check might be post-dated, and, provided the drawer has funds to meet it on its due date, the proceeding is not legally objectionable, no matter what the preceding conditions. If, however, funds are not on hand to meet his check when presented, the conditions are prima facie evidence of fraud and the burden of proof to show that no fraud was intended rests on the drawer of the check.

At the time a check is drawn the drawer must be legally competent. If he is insane, the bank, if it has knowledge of the conditions, will be liable if it honors his check.[12] Also the insolvency and assignment of the drawer acts to revoke outstanding checks and if the bank pays such checks thereafter knowing the conditions, it does so at its own risk.[13] The death of the drawer also acts as a revocation of all outstanding checks,[14] though a bank paying a check shortly after the death of the drawer and without knowledge of the facts, could not be held liable.[15]

An overdraft will not necessarily subject the drawer to a penalty. In order to sustain criminal action against the drawer in such case, it must be shown that he drew the check with full knowledge of the fact that his funds were insufficient to meet it and that he did so with intent to defraud.

§ 221. Signature.

The signature to a check merely serves as an evidence of its authenticity and as a means of identifying the account to which the payment is to be charged. Its form is therefore un-

[12] Riley v. Savings Bk., 36 Hun 513 (1885); Anglo-Am. Bank v. Ames, 27 Fed. Rep. 727 (1886).

[13] Beauregard v. Knowlton, 156 Mass. 395 (1892); Dana v. Third Nat. Bk., etc., 95 Mass. 445 (1866).

[14] Nat. Com. Bk. v. Miller & Co., 77 Ala. 168 (1884); Simmons v. Cin. Sav. Soc., 31 O. St. 457 (1877)

[15] Brennan v. Mfg. Nat. Bk., 62 Mich. 343.

important. The chief requisites are that it be distinctive and not vary. A signature once filed with the drawer's bank should not be altered in any particular unless for good cause and after full notice to the paying teller of the bank. A signature omitted from a check could not be supplied by anyone save the drawer or his duly accredited agent.

The position of the signature on the check is immaterial and it may be written in pen or pencil or even be stamped.[16] A stamped signature is, however, objectionable on account of the ease with which it may be counterfeited. If a stamped signature is used the bank could not be held liable in case of a forgery if so well executed as to be indistinguishable by the exercise of ordinary care.[17]

The corporate check should—not necessarily but as a mere matter of proper form—be signed with the formal corporate signature affixed by the treasurer.[18] If, however, the proper corporate authorities prefer to have checks signed with the individual or official signature of the treasurer or of the president, or with any special signature, instead of the corporate signature, the matter is entirely within their discretion. Ordinarily the signature or countersignature of some other officer of the corporation is desirable as a safeguard against improper payments on the part of the disbursing officer.

It occasionally happens that a corporation will have several different accounts in the same bank and will indicate by variations of signature the particular account to which each check is to be charged. These signatures may not even show that the payments are made by the corporation. They are merely identifying marks. The checks are, however, duly paid when presented and are charged to the accounts indicated by the particular signature. There are no legal objections to the practice.

[16] Pennington v. Baehr, 48 Cal. 565 (1874); Brown v. Bank, 6 Hill (N. Y.) 443 (1844).

[17] Robb v. Pennsylvania Co., etc., 186 Pa. St. 456 (1898).

[18] See Chap. XXXIII.

§ 222. (d) **Drawee.**

The drawee—that is, the bank, trust company or banker upon which a check is drawn—must be designated with reasonable precision. Usually the name of the bank is printed upon the blank check forms, so that when such forms are filled out there can be no ambiguity as to the drawee.

If, however, the printed form were not used and the check were written or stamped, the accidental omission of the name of the bank could be rectified by the holder, if he could do so in accordance with the intent of the drawer, i. e., could supply the name of the bank the drawer intended the check to be drawn upon.[19]

§ 223. (e) **Payee.**

The payee of a check—that is, the party in whose favor it is drawn—is usually designated with precision. If not and the maker's intention cannot be discovered from the check, the instrument is fatally defective and will not be paid by the drawee bank.

Ordinarily checks are drawn in the following form: " Pay to the order of John Wilson " or " Pay to John Wilson or order." Occasionally the negotiable phrase is omitted and the check is merely drawn in favor of some certain payee as " Pay to John Jones." Frequently some indefinite expression will be used, as " Pay to Bearer," " to Cash " or " to Rent."

When a check is drawn to the order of the payee, it may be collected by the payee in person or he may transfer it by endorsement to some other specified person, or may merely endorse it in blank, i. e., sign his name on the back of the check which makes it transferable by delivery and payable to any legitimate holder.

If the check is made payable to some certain person only, the words " or Order," " or Bearer " being omitted, the negotiability of the check is destroyed.

[19] See § 269.

If some indefinite words are used to indicate the payee of a check, such as "Cash," "Bearer," etc., or it is drawn payable to some fictitious person, such check is regarded in law as payable to bearer, and is then transferable by mere delivery without endorsement. The drawee bank, in the absence of suspicious circumstances, may pay such a check to any holder, even though a stranger, without identification and without danger of liability.[20]

When a check is payable to a certain person or his order, the drawee bank may always demand proper identification of the payee, or if not presented by the payee, of any indorsee by whom it is presented for payment, before honoring the check. The equity of this is obvious. If the bank pays the check to any other party than the one to whom it is rightfully payable, it must bear the loss. Therefore, its only protection in case the check is presented by a stranger, is a proper identification.

Just what constitutes proper identification will vary with the circumstances and rests almost entirely with the bank. Generally speaking, the bank will not impose unreasonable conditions but it must be satisfied before it can be required to pay the check, and the party by whom it is presented usually has practically no choice but to comply with the bank's requirements. If he deems the bank unreasonable he may, if he wishes, return the check to the drawer and demand some less difficult method of payment.

In most of the states a check does not operate as an assignment of the drawer's funds and the payee therefore has no rights against the drawee bank in case of any refusal of payment.[21] The drawer has given an order on the bank and if his order is not honored, the matter is between him and his bank and not between the payee and the bank.

In Nebraska and some other states, however, the rule is different. It is held in these states that a check is an assign-

[20] See § 262h.

[21] Bank of Republic v. Millard, 10 Wall. 152 (1869); for rights of payee of certified check, see § 231.

ment of the funds it calls for and that the payee has a claim against the bank if it refuses to pay such check when the drawer has funds on hand sufficient for its payment.[22]

It may be noted that except in certain special cases hereafter referred to, the payee is held responsible for the validity of a check transferred by endorsement. His name on the back of the check is regarded as a guarantee of its validity and if the check is not paid, he must make good any loss to the parties who received the check through him.[23]

It may also be noted that in practice when a check is deposited by a responsible party, the bank will pass many minor irregularities because of their confidence in the depositor. A missing date will be readily inserted; the difference between the amount in figures and the amount in words will be overlooked; a defective designation of the payee will be disregarded, and all this is done because the bank knows that in case of any failure of payment, or of loss arising from such irregularities, the party by whom the check is endorsed is responsible and will make it good.

§ 224. Collection.

As the check is merely an order for money, the payee when he accepts this order must use due diligence in its collection. If he does not, any resulting loss must be borne by him. Thus, if the bank fails before the negligent payee presents his check, any loss falls on his shoulders. He failed to collect when he might and must stand the consequences of his lack of proper diligence.[24]

The general rules governing the collection of checks require that a check must be presented for payment with all reasonable promptness and this presentation must be to the proper

[22] Simmons v. Bank, 41 S. C. 177 (1893); Fonner v. Smith, 31 Neb. 107 (1891); Doty v. Caldwell (Tex.), 38 S. W. Rep. 1025 (1897).

[23] See § 225, "Endorsement"; also § 236, "Forged Checks."

[24] Industrial Bank v. Bowes, 165 Ill. 70 (1897); Taylor v. Sip, 30 N. J. L. 284 (1863).

official—who is usually the paying teller—of the bank upon which the check is drawn, within the bank and during banking hours.

What constitutes proper diligence on the part of the payee in presenting a check, varies with the conditions, but it has been held that a check on a bank in the same town or city in which the payee lives, must be presented at the bank for payment within banking hours not later than the banking day following its receipt.[25] If the bank on which the check is drawn is in another town or city, the check should either on the day of its receipt or within banking hours on the day thereafter, be mailed to the drawee bank, or be deposited for collection in the payee's town. If the check is deposited for collection, the bank to which it is sent and which is charged with its actual collection, must present the check not later than the day after its receipt.[26]

The bank in which a check is deposited for collection, and, if payable elsewhere, the bank to which it is sent for collection, are regarded as agents of the payee, and if either is negligent in the matter and loss results, it will be the loss of the payee.

Prompt notice of any failure on the part of the bank to pay his check must be given the drawer of the check and any endorsers if they are to be held.[27] (See §§ 296-302.)

In any case of loss attributed to delay in presentation, the date of the check is not conclusive evidence of the time of its delivery to the payee. The check may have been dated wrongly, or may have been held by the drawer after it was drawn and the matter of delivery, if questioned, is therefore one of proof.[28]

It may be noted that while all rules of sound business require the prompt collection of a check, the payee does not

[25] Smith v. Miller, 43 N. Y. 171 (1870); Mohawk Bank v. Broderick, 10 Wend. 305 (1833); Bickford v. First Nat. Bk. of Chicago, 42 Ill. 238; see § 290.

[26] Burkhalter v. Second Nat. Bk., 42 N. Y. 538 (1870).

[27] Martin v. Home Bank, 160 N. Y. 190 (1899); Taylor v. Sip, 30 N. J. L. 284 (1863).

[28] Cowing v. Altman, 71 N. Y. 435 (1877).

necessarily lose any rights by delay. No matter when he presents the check, if the bank is still solvent, the check unrevoked, sufficient money therein to the drawer's credit to satisfy the check, the drawer uninjured by the delay, and no statutory limitations have intervened, the check is still valid.[29] If, however, any loss results from the delay, it must be borne by the payee himself.[30] The drawer has done his part toward payment of the debt and if his purpose has been defeated or he has been injured by the negligence of the payee, it is but just that the payee should be the one to suffer.

§ 225. Endorsement.

As already stated, a check drawn to the order of the payee may be transferred to another party by proper endorsement.[31] This endorsement may specify the party to whom the check is to be paid or may be in blank, i. e., merely the signature of the payee. If the endorsement is to a certain party, the check must be endorsed by him before it may be again transferred, but if the endorsement is in blank the check may then pass from hand to hand without further endorsement and may be collected by any legitimate holder. The check is then in effect the same as one made payable to bearer, the ownership passing by delivery.

When the payee of a check endorses it properly and delivers it for value to an endorsee, he does so, unless otherwise expressly understood, with the imp!ied contract or agreement that the check is good. If on presentation with all due promptness, payment of the check is refused or fails, the endorsee may have recourse on the payee from whom he received the check or on the drawer of the check. This is also true where a check has passed through a number of hands, each holder transferring the check by endorsement. The last endorsee, if

[29] See § 234, "Stale Checks."

[30] Bull v. Bank, 123 U. S. 105 (1887).

[31] See § 270.

payment of the check is refused, may hold any or all of the preceding endorsers, or the drawer of the check at his discretion.[32] An endorsement for a special purpose, however, as " for collection " or made " without recourse," will not render the endorser liable.

When a check is presented for payment or for deposit, the receiving bank requires the signature of the payee to be endorsed on the back of the check. This endorsement is regarded and serves as a guarantee of the validity of the check and also as a receipt for its payment.

§ 226. Payment of Checks.

If a check presented for payment lacks any of its essential features, the bank may refuse payment absolutely until such deficiencies are supplied. Also if there are any suspicious circumstances connected with the check or its presentation, the bank has a right to delay payment until it has had proper time to investigate these circumstances.

If, however, a check is properly drawn against funds on general deposit, is in the hands of a rightful holder known to the bank and is presented for payment at the bank within banking hours, the bank must honor the check.[33]

If the bank refuses payment of such a check, the payee cannot himself enforce payment but may proceed against the drawer of the check for the original debt which the check was intended to satisfy. The status of this debt has not been changed in any way by the delivery to the payee of a check that proves worthless. Or if the payee prefers, he may substitute the check as his cause of action and proceed to collect its amount from the drawer.

The drawer on his part may bring suit against the bank to enforce payment of his check if he so desires and may also

[32] Bank v. Bank, 29 N. Y. 619 (1864); Emery v. Hobson, 62 Me. 578 (1873).

[33] Bickford v. Bank, 42 Ill. 238 (1866); State Nat. Bk. v. Reilly, 124 Ill. 464 (1888).

hold the bank for any damages resulting to him from its failure to honor his check. The whole question is, however, one that seldom arises. Banks but rarely refuse to pay checks properly drawn and properly presented by parties entitled to payment.

Payment of any particular check or payment of all checks against a particular deposit may be stopped at any time by revocation or by direct order of the drawer, by proper legal proceedings such as an attachment, by the insanity or death of the drawer, when known to the bank, or by insolvency and assignment after notice. Speaking generally, the bank will not be held liable if it pays checks under any of these conditions before it has been notified or has knowledge of the conditions. Thereafter it pays such checks at its own risk, save that in some few states payment of checks after the drawer's death may be made within a stated period.

If the payee does not wish to draw his money at once, he may have the check certified. This eliminates the drawer who no longer has any control over the check or its amount, and makes the bank a debtor to the payee for the amount of the check.[34]

Checks are not due until presented for payment, hence are payable in the order of presentation regardless of their dates. If checks are presented calling for amounts in excess of the depositor's balance, the bank may refuse payment, or may pay the full amount, charging up the difference between the depositor's balance and the amount paid, to the depositor.[35]

[34] See § 231, "Certified Checks."

[35] See § 233, "Overdrafts."

CHAPTER XXIII.

CHECKS.—(Continued.)

§ 227. Payment by Check.

In practice a check is usually regarded as payment—to its amount—of the debt or other obligation against which it is given. It is, however, in itself no payment, unless the payee so elects, but is merely an order for money which, when received, is a good payment.

The drawer may, if he sees fit, revoke the check before it is paid, or withdraw his funds, or the bank may become insolvent or refuse to honor the check, or other contingencies may arise to prevent its payment. In any of these cases the payee does not receive the money called for by his order. His claim is therefore not paid, and, provided only that the failure of the check was not due to some delay on the part of the payee in presenting the check for payment,[1] he may have recourse on the drawer for the original claim or, if he so elects, for payment of the check.[2]

As a check is not in itself payment of a debt, the creditor may decline to accept it without legal prejudice to his claim. He cannot be forced into the position of a collecting agent for his debtor against his will and may, if he sees fit, insist upon payment in legal tender—a right that is rarely exercised.

It may be noted in passing that the receipts so commonly

[1] See § 224.

[2] Bradford v. Fox, 38 N. Y. 289 (1868); Burkhalter v. Second Nat. Bank, 42 N. Y. 538 (1870).

given when a check is received are merely prima facie evidence of payment which may, if the check fails and the payee proceeds to collect upon the original debt, be set aside by proof of the actual conditions.

§ 228. Depositing Checks.

As a rule, checks are not collected directly by the payee but are deposited by him in his own bank,[3] either for collection or credit according to the conditions. If accepted by the bank for credit, they are entered in the depositor's pass book and the effect is the same as if cash had been deposited, i. e., the depositor is entitled to check against his credit at once without waiting for the collection of the checks. If any of the checks so credited fail when presented for payment, the bank returns the dishonored checks to the depositor and either charges them to his account, or requires him to make them good.

If, for any reason, the bank is not willing to credit the deposited checks or the depositor does not wish them to be credited to his account, they are taken by the bank for collection. In this case the bank merely accepts them upon memorandum and does not credit them to the depositor's account until they have been actually paid. The depositor is notified of every such credit as it is made, and any checks which fail are returned to him, usually with an explanation of the reason for their non-payment.

Checks deposited for collection constitute a special deposit and in case the bank in which the checks are held should fail before the checks have been collected, they can be recovered by the depositor. If, however, checks are once credited to his account, they are taken on general deposit and if the bank fails thereafter, the depositor cannot recover them, even though they have not yet been collected.[4]

Checks for deposit are usually endorsed payable to the order of the bank in which they are deposited. Any endorse-

[3] See § 224.
[4] See § 212.

ment used must, of course, be acceptable to the bank as it cannot be forced to receive checks against its will.[5]

The endorsement of a check is always placed upon its back. If placed on the face of the check, it would be unusual, inconvenient and obviously out of place.

§ 229. Return of Cancelled Checks.

A bank will not pay a check unless it is properly drawn by the maker and endorsed by the payee. After payment the check is stamped or cancelled in such way as to indicate that it has been paid. The cancelled checks therefore contain a complete record of the transaction.

Properly this record belongs to the bank as the cancelled check is the proper and unquestionable evidence of the payment made by it for account of the depositor. As a matter of practice, however, the bank returns these cancelled checks to the depositor. The custom, though it occasionally works a hardship upon the bank, is almost universal and is a matter of very great convenience to the depositor.

Cancelled checks are returned by the bank at regular or irregular intervals as the depositor's pass book is balanced,—a statement of his account being handed him with the balanced pass book and cancelled checks. The return of his vouchers and balanced pass book is not, however, in the nature of a "closed account." On the contrary, unless otherwise agreed between the bank and the depositor, mistakes discovered thereafter by either party may be rectified at any time without regard to the entries of the pass book.

Cancelled checks when returned should be examined promptly and compared with their respective stubs. In some cases the only way in which forgeries can be discovered is by this comparison, and if it is not made promptly, such forgeries may on occasion be charged to the depositor on the ground that he has been negligent.[6]

[5] See Chap. XXXIII.

[6] Leather, etc. Bank v. Morgan, 117 U. S. 96 (1886); Janin v. London & S. F. Bank, 92 Cal. 14 (1891).

§ 230. Voucher Checks.

Certain features are essential to the validity of a check[7] and must appear upon it. In addition thereto the drawer may enter any other matter on the face or the back of the check that he sees fit and the check is still valid so long as the added matter does not modify or seriously obscure its essential features and does not change the nature of the instrument.

For instance, if the party giving a check so desires, his address and the nature of his business may appear on its face, or the item for which it is tendered in payment may be entered, or a complete statement of the account the check is intended to settle may be embodied, or the check itself may be made merely part of an extended statement of the account in payment of which the check is given. In short, so long as the essential features of the check are not materially interfered with and the bank does not object, the drawer may put any matter on his checks relevant or otherwise that may seem to him desirable.

Add to this the fact that no money can ordinarily be secured upon a check until the payee endorses his name on the back, that payment is still further evidenced by the cancellation of the paying bank and that the check is finally returned to the drawer, and it will be seen that the check itself affords a singularly complete and convenient history of the entire transaction. This has led to the adoption of many forms of receipt or voucher checks.

Further opportunities for this use of the check are afforded by the fact that the check itself may require certain prescribed things to be done before the amount it calls for will be paid, as for instance, that the payee must sign a formal receipt which is incorporated in the body of the check, or must concede the correctness of the account or must admit the finality of the payment.

The general convenience of voucher checks has, as stated, led to their extended use in a great variety of forms. Many of

[7] See §§ 217, 262.

these are no larger than the ordinary check, containing perhaps a brief statement of the item in payment of which the check is given. From this the voucher check ranges up to blanket sheets of large size, voluminous as to matter and troublesome as to requirements both to payees and banks.

These larger voucher checks undoubtedly do give a very complete statement of the account and its payment, but they are an imposition upon those who must handle them, and, save in exceptional cases, are hardly justifiable. On the other hand, the modest voucher check so frequently seen containing either on face or back a brief statement of the account for which it is given, is not objectionable on any score and may be made to supply every ordinary requirement of statement and receipt. Such a voucher check is no more difficult to handle than the usual form of check and its use is a matter of convenience and economy to both drawer and payee.[8]

§ 231. Certified Checks.

A certified check is one upon which the drawee bank has stamped or written the word "Accepted" or "Good" or "Certified" or some similar expression, together with the signature of the certifying officer. When a check is so certified, its amount is charged up against the drawer's account and the check becomes a direct obligation of the bank itself.[9]

A certified check once out of the drawer's hands is also out of his control. He can neither revoke the check nor withdraw the funds, because its amount has already been charged against his account and is held for payment of the outstanding check. If the bank refuses to pay a certified check, the payee must himself institute the necessary legal proceedings against the bank to enforce payment. He has no claim against the original drawer nor could this original drawer bring suit against the bank because of its refusal to pay his certified check.

[8] See § 90; also Forms 7-9.

[9] G. N. Bank v. Bingham, 118 N. Y. 349 (1890); Merchants' Bank v. State Bank, 10 Wall. 604 (1870).

One exception must be noted to the general statement that the drawer is no longer a party to a certified check. If the drawer himself has a check certified and hands it to the payee, the bank is primarily liable for its payment, but the drawer, in case the bank should fail to pay the check, is still liable for its amount. The payee cannot be forced to accept the bank as his debtor instead of the drawer. If, however, the drawer merely hands the uncertified check to the payee and the payee himself has it certified, the drawer is released. The payee has then voluntarily accepted the bank instead of the drawer as his debtor for the amount. It was his own act and the indebtedness of the drawer for which the check was given is thereby extinguished.[10] Certification is payment so far as the drawer is concerned.

The status of the holder of a certified check differs materially from that of the holder of an uncertified check. In the case of a certified check the indebtedness of the bank is to the check and follows it, and if the check is not paid on presentation, the holder, whether he be the payee or some endorsee, may enforce payment from the bank by direct legal procedure.[11]

As a certified check represents a direct obligation of the bank, which follows the check, and as this check is not subject to revocation, its proper delivery is equivalent to an assignment of the funds held for its payment. Certified checks are therefore usually regarded as the equivalent of cash and are so received in most commercial transactions. They are good as long as the bank is solvent.

It may be noted, however, that if a bank certifies a check in error, as for instance, when the depositor's funds are less than the amount of his check, and discovers the error before

[10] Met. Nat. Bank v. Jones et al, 137 Ill. 634 (1891); First Nat. Bank v. Leach, 52 N. Y. 350 (1873); Thomson et al v. Bank of British N. A., 82 N. Y. 1 (1880).

[11] Born v. First Nat. Bk., 123 Ind. 78 (1889); First Nat. Bk. v. Whitman, 94 U. S. 343 (1876); Met. Nat. Bk. v. Jones et al, 137 Ill. 634 (1891).

the check has passed from the hands of the payee or holder for whom it was certified, the bank may recall the certification.[12]

If certifications in excess of the amount actually on deposit to the credit of the drawer are not in error, they are absolutely binding as to the bank and the full amount of such certified checks must be paid upon presentation.[13]

National banks are prohibited by law from over-certifications. In state and private banks no such restrictions exist. In practice in these and in national banks as well, regardless of the prohibitive laws, it is common to certify checks in excess of the drawer's deposit. Usually this is done with the expectation that the deficit will be made good within a reasonable time, which is usually within banking hours of the same day, or otherwise, when the bank officials are willing to advance the drawer the deficiency on his check as a loan.

If for any reason a certified check is turned back to the drawer, the payee usually endorses the check and the drawer deposits it to his credit as he would any other check. If, however, as sometimes happens, a certified check has not passed from the drawer's hands and he wishes to realize upon it, an endorsement by the payee is not always practical. In such case the bank officials look to the real ownership of the check and if they are convinced that the drawer holds it properly, they will usually retransfer its amount to the drawer's account upon his endorsement and surrender of the check.

If a certified check is altered after certification, the bank is not liable in any way for the increased amount but only for the amount originally certified.[14]

§ 232. Revocation of Checks.

A check may be revoked at the drawer's option at any time before payment.[15]

[12] Irving Bank v. Witherald, 36 N. Y. 335 (1867); Freund et al v. Importers & Traders Nat. Bk., 76 N. Y. 352 (1879).

[13] Espy v. Bank of Cincinnati, 18 Wall. 604 1873); Irving Bk. v. Witherald, 36 N. Y. 335 (1867).

[14] N. Bank of C. v. N. M. Bank. A., 55 N. Y. 211 (1873).

[15] Albers et al v. Commercial Bank, 85 Mo. 173 (1884); German N. Bk. v. Farmers' D. N. Bk., 118 Pa. St. 294 (1888).

In some few states a different rule prevails. The courts in these states hold that the delivery of a check operates as an assignment of the drawer's funds to the amount called for by the check, and that if the drawer has on deposit at the time of presentation sufficient funds for payment of the check, the payee may sue for and recover the amount from the bank in case his check is not paid. The courts also hold that a transfer of the check vests the same right in each successive holder and that it is not in the power of the drawer to countermand the check after delivery by him.[16]

This doctrine is unusual and leads to obvious difficulties, it obtains in Nebraska, Texas and South Carolina. In all of the other states of the Union the right of the drawer to revoke his check at any time before actual payment is fully recognized.)[17]

Revocations should be written. Verbal or telephonic instructions are effective but should be promptly confirmed by a written order. A revocation may be of one particular check or may be a blanket revocation covering all checks outstanding, or it may be of all checks issued before or after a certain date or between two dates, or up to a certain period. Usually, however, a revocation is of one particular specified check and the instructions should specify number, date, amount and payee of the revoked check.

A revoked check is absolutely ineffective and the drawee bank has no discretion as to whether it shall be paid. Should it pay such a check it does so entirely at its own risk.

All outstanding checks of a depositor are revoked automatically by his death, save as to such checks as may be paid by the bank before it has knowledge of the conditions, and except in some few states where the checks of a deceased depositor are payable for a certain limited period after his death. The insanity or the insolvency and assignment of the drawer

[16] Fonner v. Smith, 31 Neb. 107 (1891); Doty v. Caldwell (Tex.), 38 S. W. Rep. 1025 (1897).

[17] 5 Cyc., p. 538.

with notice to the bank also has the effect of revoking all outstanding checks.[18]

§ 233. Overdrafts.

A check in excess of the amount to the drawer's credit is termed an overdraft. It may be paid or refused at the discretion of the bank. If the overdraft is intentional on the part of the drawer and is paid, it is merely a method of borrowing from the bank, and even though there is no express agreement to that effect, the drawer is liable to the bank for the excess amount.

National banks are prohibited by law from allowing overdrafts but, as already stated, frequently do so in spite of this prohibition. If an overdraft is presented to a state or private bank, its payment is merely a question of whether or not it shall accommodate the drawer. If he is a responsible party and a good customer, the accommodation is usually granted.[19]

A check on a bank in which the drawer has no funds is not an overdraft. Unless drawn inadvertently, or covered by a deposit before presentation, such check would be clearly fraudulent and would subject the drawer to criminal prosecution.

§ 234. Stale Checks.

It occasionally happens that checks are not presented for months and even years after their dates. Such checks are said to be stale. They are, however, in themselves perfectly valid and, provided the bank is still solvent, the check unrevoked, the drawer's deposit still in the bank and sufficient in amount to meet the check, and provided further that no statutory limitations have intervened and that the delay in collection has involved the drawer in no loss, the check is still valid.[20]

Any excessive delay in presenting a check is, however, always a suspicious circumstance—sufficient to put the bank on

[18] Riley v. Albany Sav. Bk., 36 Hun (N. Y.) 513 (1885); see § 220, *infra.*

[19] See § 231.

[20] See § 224.

inquiry.[21] The bank is therefore fully justified in any such case in delaying payment until the drawer can be communicated with, or in requiring the payee to secure the drawer's endorsement of his check, or a statement from him that the check is still in good standing.

§ 235. Lost or Destroyed Checks.

As a check is merely an order for money, its loss does not necessarily involve the loss of any actual values. The drawer still has his money and the payee his unpaid claim. The payee's proper course is to secure a duplicate of the lost or destroyed check, or if this is refused, to proceed against the drawer for payment of the original account.

The only danger in duplicating a check alleged to have been lost or destroyed, lies in the possibility that these statements are false and made for the purpose of fraudulently obtaining a second check. If the payee has parted with the first check for a sufficient consideration and it is in the hands of an innocent holder for value, this holder—unless he delays presentation unduly—can collect the amount of the check, even though a duplicate has been issued. His check would undoubtedly and properly be refused by the drawee bank but the holder could then have recourse on the payee and on the drawer as well and his claim would be good.[22]

For this reason, unless the drawer is absolutely satisfied of the truth of the payee's contention that his check has been lost or destroyed, as the case may be, he should either delay the issue of a duplicate check for a sufficient length of time to void the preceding check for lack of diligence in its presentation, or otherwise require a bond of indemnity from the payee before issuing a duplicate check.

Lost checks afford one of the few instances outside of the insolvency of the drawee bank in which an innocent holder may

[21] Morse on Banks, § 443.

[22] Morse on Banks, § 395a.

suffer if he fails to present his check promptly for payment. If a check, supposedly lost, is not presented with reasonable promptness, the drawer is justified in issuing a duplicate check on the presumption that the first has been lost. Then if the holder of the original check presents it for payment, and the duplicate has already been paid, the drawer can show material injury resulting from the delay in presentation, and the loss would fall on the holder.

In case of the loss of a check—especially if it be endorsed in blank—both the drawer and the bank should be notified as promptly as possible. The bank is then put " on notice " and if the check is presented for payment before a revocation, it will in self-protection either refuse payment entirely or delay the matter until the status of the check and the real rights of the holder can be determined.

§ 236. Forged Checks.

If a bank pays a forged check supposedly drawn by one of its depositors, it cannot debit the amount of such check against the account of the depositor, nor has it rights of any kind against him unless it can show that the loss resulted through some fault or negligence on his part.[23] Neither can the bank recover the amount of the check from the payee, or an endorsee, if the check is presented by him in good faith and he had no reason to suppose it to be fraudulent. The mistake is the mistake of the bank and, generally speaking, no matter how skilful the forgery nor how well calculated to deceive, the bank alone must suffer.[24]

The justice of this is obvious. As to the party in whose name a forged check is drawn, he has given the bank no instructions to pay out his funds, and, in the absence of such order, the bank cannot charge him with payments it has made even though on orders they believed to be his.

[23] Shipman et al v. Bank, 126 N. Y. 318 (1891); First Nat. Bk. v. Rease. 168 Ill. 40 (1897); see § 272, "Forgeries."

[24] Weisser v. Denison, 10 N. Y. 68 (1854); Cooke et al v. United States, 91 U. S. 389 (1875).

As to the payee or endorsee of a forged check, the bank's inability to recover is in the nature of a penalty for its remissness in not detecting the counterfeiting of a depositor's signature with which it should be familiar.

This penalty is, however, only inflicted when the party from whom the check is received is acting in good faith and has himself exercised all due diligence. If the bank can prove that he is not an innocent holder, or can show any fault on his part which has led the bank to be less careful in its scrutiny of the check than would otherwise have been the case, it can recover from him. Thus the mere possession of a forged check by responsible parties, or their neglect to mention suspicious circumstances connected with its acquisition,[25] might be sufficient to lull the bank into a false security and prevent the care which they would otherwise have exercised.

If the holder of a forged check presents it for payment or deposits it in his own bank, which is not the drawee bank, and the drawee bank discovers the forgery, the first bank can recover from the payee, even though the check was received and deposited by him in all good faith. The receiving bank in such case is not supposed to know the signature of the maker of the check, is not at fault in the matter and therefore cannot be held liable for any loss.

Occasionally a check will turn up which is correct as to signature and as to every other requirement save as to the endorsement which is forged. In such case the drawee bank must submit to any loss involved if it pays the check.[26] This rule is based on the ground that the bank may only pay a check to the party designated by the drawer or to the endorsees of such party. If, then, it pays the check to some party who is neither the owner nor the endorsee by right, the bank alone is responsible.

[25] Nat. Park Bk. v. Ninth Nat. Bk., 46 N. Y. 77 (1871).

[26] Bank of Republic v. Millard, 10 Wall. 152 (1869).

§ 237. Alterations of Checks.

Any material alteration in a check after it is once drawn, by any party save the drawer, renders the check void.[27] If such a check is paid, the bank must usually bear the loss, but an exception arises where the drawer of the check makes such alterations possible by his own negligence.

The most common instance of this is such careless drawing of a check as to permit the easy insertion of additional figures and words, increasing the amount. If such alterations are made and are not easily discoverable, any resulting loss falls on the maker. It has been brought about by his own carelessness and he is held to be the proper and only party to suffer.[28]

Other forms of negligence may occur as for instance, where a depositor failed to compare his cancelled checks promptly on their return and did not discover the continuing alterations made by his own confidential clerk. These changes were very skilful and the circumstances were free from suspicion—so much so that the court held the drawer was himself to blame and fastened the loss upon him.[29]

Even though the depositor is himself negligent, the bank will, however, be held liable for losses due to alterations unless the changes are so skilful and so difficult to detect as not to be discoverable by the exercise of ordinary vigilance.

[27] See § 273.

[28] Mahaiwe Bank v. Douglass, 31 Conn. 170 (1862); Belknap et al v. Nat. Bk. of N. A., 100 Mass. 376 (1868).

[29] Leather, etc. Bk. v. Morgan, 117 U. S. 96 (1885); Myers v. Bank, 193 Pa. St. 1 (1899).

CHAPTER XXIV.

DIVIDENDS.

§ 238. What They Are.

Dividends are corporate profits which have been set aside by formal action of the directors for distribution among the stockholders.

Quarterly, semi-annually or annually, as the case may be, the corporate books are balanced or the profits are otherwise determined and the directors decide what portion, if any, of these profits shall be withdrawn for division among the stockholders. If a dividend is determined upon, it is then formally declared, usually in the shape of a percentage on the par value of the stock but sometimes as a fixed amount on each share. The amount received by each stockholder is therefore determined absolutely by the number of shares he holds.

Corporate profits are occasionally disbursed among the stockholders without the formality of a declaration of dividends, and the proceeding is not legally objectionable if all the stockholders consent.[1] Where the corporation is small, this is sometimes effected by means of salaries that would otherwise be unreasonably large. In such cases, all the stockholders are usually also officials of the corporation and participate in this informal division of profits. The plan is permissible if all the parties in interest assent[2] and no improper ends are to be at-

[1] Groh's Sons v. Groh, 80 N. Y. App. Div. 85 (1903).
[2] Fichett v. Murphy, 46 N. Y. App. Div. 181 (1899); see § 243 *infra.*

tained thereby. When, however, such salaries are paid for the purpose of concealing the actual profits with a more or less directly fraudulent intent, the courts hold them as "dividends of profit under another name and put in that guise for concealment and delusion."[3]

§ 239. By Whom Declared.

It is a well recognized principle of law that "the directors of a corporation and they alone have the power to declare a dividend of the earnings of the corporation and to determine its amount."[4]

This right of the directors to declare dividends is an incident of their general power to manage the affairs of the corporation and is recognized either directly or by implication by the statutes of every state of the Union. The right is, of course, controlled by any statutes, or any charter or by-law provisions which may apply, but beyond this the whole matter is in the directors' discretion.[5]

§ 240. Nature of Declared Dividends.

The property of the corporation is not the property of the individual members. They are interested in the corporation, but as individuals have no interest in its property. "The individual members of the corporation are no doubt interested in one sense in the property of the corporation, as they may derive individual benefit from its increase or loss from its destruction, but in no legal sense are the individual members owners."[6]

When, however, a dividend is declared from net profits, the amount of this dividend is immediately transferred from the corporate ownership to the ownership of the stockholders[7]

[3] Rubber Co. v. Goodyear, 9 Wall. 788 (1869).

[4] Hunter v. Roberts, Throp & Co., 83 Mich. 63 (1890).

[5] Burden v. Burden, 159 N. Y. 287 (1899); N. Y., etc. R. R. v. Nickals, 119 U. S. 296 (1886).

[6] Queen v. Arnaud, 9 Ad. & El. (N. R.) 806 (1846).

[7] Matter of Kernochan, 104 N. Y. 618 (1887).

and this is true though no definite date or some future date was fixed for its payment at the time it was declared.[8] As soon as the date arrives upon which this dividend is payable, it becomes a debt due from the corporation to the stockholders, who can enforce its payment by legal procedure if withheld.

"It is a clear proposition that a dividend declared of the earnings of the company becomes thereupon the individual property of the stockholder to be received by him on demand. It is a severance from the common fund of the company of so much for the use and benefit of each incorporator in his individual right which may be demanded by him, and if refused become the subject of an action for money had and received to his use."[9]

The ownership of the profits declared as dividends passes from the corporation to the stockholders as soon as the declaration is made absolute, and such profits cannot be again reclaimed by the corporation. The dividend is then a debt of the corporation which stands on a parity with its other debts, and should the corporation become insolvent before such dividend is paid, the stockholders take their place among the other creditors of the corporation and may enforce their claims as would any other corporate creditor.[10]

Further than this, if the money to pay a declared dividend is set aside in a separate fund for the purpose, even though merely placed on deposit, it has been held that this particular fund becomes the absolute property of the stockholders—a trust fund held by the corporation for their benefit—and provided only that the dividend is legal and the fund is set aside in good faith, such fund cannot be reclaimed by the corporation nor is it liable to taxation or for the corporate debts.[11] However, "simply declaring a dividend does not create a trust fund. To create such a fund some specific sum of money must

[8] Beers v. Bridgeport Spring Co., 42 Conn. 17 (1875).
[9] King v. Paterson, etc. R. R., 29 N. J. L. 82 (1860).
[10] Hunt v. O'Shea, 69 N. H. 600 (1899).
[11] Pollard v. First Nat. Bk:, 47 Kans. 406 (1891).

be set apart for paying the dividend. Until this is done, the relation of the corporation to its stockholders in respect to dividends is that of debtor and creditor."[12]

A dividend does not, however, become an irrevocable fact until notice of the resolution declaring it has been given, or the fact that it has been adopted has become known. If the directors have voted the dividend but the fact has not been made public in any way, the transfer has not been consummated and the action of the board up to this point may be rescinded and become a nullity.[13]

Also under some circumstances a formally declared dividend may be revoked. Thus should the board declare a dividend in defiance of or in ignorance of facts which make it illegal, the action of the board may be rescinded at any time before payment of the dividend has actually been made or its payment may be enjoined at the suit of objecting stockholders.[14]

As a declared dividend is a debt due from the corporation to the stockholder, any real existing indebtedness of the stockholder to the corporation may be set off against the dividend and be deducted from it, provided the debt is actually due at the time the dividend is payable. Accordingly the corporation has full power to apply dividends in payment of subscriptions due on its stock from the stockholders.[15]

It may be noted that a contract between the corporation and a subscriber to its stock that his subscription shall be paid for in dividends, is absolutely invalid both as against the corporation and against corporate creditors. Under such an agreement, any credits of declared dividends actually made would be held a valid payment, but in case of the insolvency of the corporation before the stock was full paid, the stockholder could be called upon to pay in cash all amounts still due on his

[12] Hunt v. O'Shea, 69 N. H. 600 (1899).

[13] Ford v. Easthampton Rubber Thread Co., 158 Mass. 84 (1893).

[14] Marquand v. Federal, etc. Co., 95 Fed. Rep. 725 (1899).

[15] Kenton, etc. Co. v. McAlpin, 5 Fed. Rep. 737 (1880).

subscription, regardless of the agreement that it was to be paid in dividends.[16]

§ 241. Profits and Dividends.

Under the common law, dividends may be paid only from profits. This common law has been re-enacted in some form in the statutes of practically every state in the Union. Even where stockholders are entitled to interest on their stock by reason of a contract with the corporation, it has been held that such interest may only be paid from net profits.[17]

In most of the states the statutes provide that dividends may only be declared from surplus or net profits. In some few states the requirements are much lower, the statutes merely providing that no dividends may be declared that would render the corporation insolvent, or perhaps merely imposing punishment for the declaration of such dividends. It is manifest that this might allow material impairment of the actual capital before the statutory limit was reached.

Speaking generally, however, dividends may be paid only from surplus or net profits. . It then at times becomes an important point to determine just what are profits, and to what extent these profits are available for dividends.

The general rule is that any increased values of the corporate assets in any year are net profits. Or, as stated by the United States Supreme Court,[18] "The term 'profits' out of which dividends alone can properly be declared denotes what moneys remain after defraying every expense, including loans falling due as well as the interest on such loans." Or as stated broadly in an early case,[19] "the surplus over and above their capital and debts becomes profits."

"But several kinds of charges must first come out of net earnings before dividends are declared. The creditor comes

[16] Hawkins v. Citizens', etc. Co., 38 Ore. 544 (1901).

[17] Painesville, etc. R. R. v. King, 17 O. St. 534 (1867).

[18] Mobile, etc. R. R. v. Tennessee, 153 U. S. 486 (1894).

[19] Barry v. Merchants' Exch. Co., 1 Sandf. Ch. 280 (1844).

into consideration before the stockholder. The property of a corporation is a trust fund pledged for the payment of its debts. Therefore if there is a bonded, funded, permanent or standing debt, the interest on it must be reckoned out of net earnings. If there is a floating debt which it is not wise and prudent to place in the form of a funded debt or to postpone for later payment, that should also be paid. If the financial situation of the company is such as to render it expedient to commence or continue the scheme of a sinking fund and for the extintinguishment of the company's indebtedness some day or other, an annual contribution out of the net earnings for that purpose would be reasonable. These deductions made from the net earnings, the balance will be profits of the company distributable among stockholders."[20]

It will be noticed that if the definition of profits—" the surplus over and above the capital and debts"—is strictly applied, it would require that each year before dividends may legally be paid, any existing impairment of the capital must be made good. That is, if a company has no reserve of surplus profits and meets with disastrous losses, its profits, possibly for a term of years succeeding, must be employed in the reinstatement of its capital stock and during that period dividends must be deferred until the capital has been restored to its original amount.

The courts, however, do not enforce any such harsh rule. On the contrary, provided always that the state statutes, or the provisions of charter or by-laws do not prevent, and that the declaration of a dividend does not render the corporation insolvent or leave it in such an embarrassed condition as to render the dividend manifestly improper, no account need be taken of any impairment of preceding years. Under such circumstances, " in estimating the profits for the year for the purpose of declaring a dividend, it is not necessary to take into

[20] Belfast v. Belfast, 77 Me. 445 (1885).

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account the difference in value of the assets and the impairment of the capital stock of the company prior to that year."[21]

Also profits earned and invested or passed over to surplus in years of prosperity do not lose their character as profits but if no profits are made in subsequent years, may be drawn on for dividends.[22] Also profits for the current year, although expended upon betterments, or existing in the form of property, may be made the basis of dividends. In this case money may be borrowed to pay such dividends or the dividends may be declared in the form of stock, scrip or bonds.[23]

An exception to the general rule that dividends impairing the capital stock may not be paid, is found in the case of companies working mines or operating under leases, patent rights, etc. Here the corporation is organized for the express purpose of working out the property which is represented by its capital stock and the impairment and final exhaustion of this property is the object of the corporate operations.

In any such case if a company is formed " to acquire and work a property of a wasting nature, for example, a mine, a quarry or a patent, the capital expended in acquiring the property may be regarded as sunk and gone, and if the company retains assets sufficient to pay its debts, it appears to me that there is nothing whatever in the Act to prevent any excess of money obtained by working the property over the cost of working it from being divided amongst the shareholders, and this, in my opinion, is true although some portion of the property itself is sold and in some sense the capital is thereby diminished."[24] The decision in the English case from which the foregoing quotation is taken, has been generally followed in this country and is regarded as establishing the rule. It must, however, be noted that in this case the assets of the company

[21] Cook on Corps., § 546.

[22] Beers v. Bridegport Spring Co., 42 Conn. 17 (1875).

[23] Williams v. W. U. Tel. Co., 93 N. Y. 162 (1883); In re Mercantile Trading Co., L. R., 4 Ch. 475 (1869).

[24] Lee v. Neuchatel Asphalte Co., L. R. 41 Ch. D. 1 (1889);

were ample and there was no question of insolvency or charge of indiscretion in the declaration of dividends which formed the basis of litigation.

A difficulty sometimes arises when determining the corporate profits for dividend purposes as to what expenditures may properly be charged to capital stock account and what should be charged to current expenses. Thus if a manufacturing concern purchases machinery and this is charged to capital stock account, the books will show a larger net profit for the year than if the item is charged to expense account. The matter is one of bookkeeping and the actual assets of the company are not affected in either case, but its profits legally available for dividends are directly increased or diminished according to the account to which the item is debited.

This question usually arises when the directors are anxious to divert every possible penny into dividends. The problem is a difficult one and its solution will vary with the conditions. " It may be safely said that what losses can be properly charged to capital and what to income is a matter for business men to determine and it is often a matter on which the opinions of honest and competent men will differ."[25] Speaking generally, any expenditure for which stock or bonds might be issued with propriety, is properly charged to capital account but not otherwise.

§ 242. Equality of Dividends.

Dividends, as stated, are usually declared as a percentage upon the outstanding capital stock, or as a certain amount on each class of stock, and each stockholder in any class of stock participates according to the stock he holds. This rule is absolute. " When they (the directors) undertake to declare a dividend, they are bound to make it equal and just among all who are interested. They would have no right to divide their profits among a few particular friends, neither would they have

[25] Gregory v. Patchett, 33 Beav. 595 (1864).

authority to say that one class of stockholders should receive a larger amount of the profits or a greater dividend than others. They are but the agents of the stockholders. The profits belong to the stockholders and they must apportion them fairly and justly with due regard of the interests of each and all of them. They cannot make an unjust discrimination, giving one an advantage over another. If they do this, they exceed their powers and the courts have a right to interpose their authority to prevent it."[26]

The general rule of equality applies, however, only to stockholders of the same class. In the organization of a corporation, or later if the proper formalities are observed, different classes of stock may be created and these may be given different dividend rights.[27] Thus preferred stocks are frequently created with preferential dividends which they receive before other classes of stock receive anything at all. The difference is, however, one that was intended and one that is clearly set out in the provisions by which the preferred stock is created and as it is understood and by implication agreed to by every stockholder of the corporation, no injustice results.

As between the members of any one class, however, dividends must be paid with absolute impartiality. The number of shares of stock each holds must determine the amount received by him when dividends are paid. The time of payment and the method of payment must be the same for all. Some, unless by consent or agreement, cannot be paid in cash while others are paid in stock or scrip. All must fare alike.[28]

§ 243. Form of Payment.

Dividends are usually paid in cash and unless otherwise stated, cash payment is always understood. Dividends may, however, be declared from existing profits regardless of the form of these profits. " The surplus may be in cash and then

[26] Luling v. Atl. Mut. Ins. Co., 45 Barb. (N. Y.) 510 (1865); Miller, J.

[27] See Chap. XXXI, "Preferred Stock."

[28] Jones v. Terre Haute, etc. R. R., 57 N. Y. 196 (1874); State v. Balt., etc. R. R., 6 Gill (Md.) 272 (1848).

it may be divided in cash. It may be in property and if the property is so situated that a division thereof among the stockholders is practicable, a dividend in property may be declared and that may be distributed among the stockholders." Also if the profits are not in the form of cash and not in a form to be distributed directly as property among the stockholders, the property might be sold or be used as a basis for a loan of cash to be used in payment of dividends, or scrip, bonds or stock might be issued against it as dividends.[30]

Another method of disbursing profits occasionally practiced, is that of paying these profits to the officers of the corporation under the guise of salaries. The excess amount of these salaries represent the dividends that would otherwise be declared. It is obvious that this practice is only proper when all the stockholders are also officers of the corporation or consent to the otherwise excessive salaries. "So long as all the parties in interest, incorporators, stockholders, directors and officers, assented to the scheme for the distribution of assets by the payment of salaries, the plan was not objectionable."[31] But if any interested parties do not consent, the plan becomes not only objectionable but illegal.

§ 244. Cash Dividends.

The simplest form of dividends are those paid in cash. Such dividends are usually declared and paid from cash profits on hand. If, however, the profits of the company exist in some other form of property, the directors may, as already stated, sell such property and use the proceeds for the cash payment of dividends, or may borrow the cash on the security of this property or on the general credit of the corporation and pay the dividends from the money thus obtained, or they may, under proper conditions, issue stock, bonds or scrip against the property and secure cash for the payment of dividends from the sale of these securities.

[30] Williams v. W. U. Tel. Co., 93 N. Y. 162 (1883).
[31] Fitchett v. Murphy, 46 N. Y. App. Div. 181 (1889).

§ 245. Dividends Not in Cash.

If corporate profits available for dividends are in the form of property and the directors do not care to sell or encumber this property, or if they wish to reserve the cash profits for the use of the corporation, dividends may be declared in several different forms. (a) The capital stock may be increased and this increase be distributed as a stock dividend, or any unissued or treasury stock on hand may be used for the purpose. (b) Bonds may be issued to the amount of the dividend and these bonds be distributed. (c) Scrip may be issued against the profits and the scrip be distributed as dividends. (d) If the property is in such shape as to permit, it may itself be distributed as a property dividend.

Dividends in all these different forms, if issued under proper conditions, are held to be legal and are sustained by the courts.[32]

In the case of dividends paid in other forms than cash the same general rules apply as to cash dividends. There must be an equality among the stockholders, and the proportionate amount, the time of payment and the form in which the dividend is paid must be the same for all.

It may be noted that preferred stockholders share with holders of common stock in dividends paid in other forms than cash exactly as they would if the dividends were paid in cash.[33]

§ 246. (a) Stock Dividends.

In some few states stock dividends are prohibited by law, as in Massachusetts. Even here, however, the end is practically accomplished by the declaration of a dividend to the stockholders. These dividends are then a debt due from the corporation to its stockholders. A simultaneous offering of stock to an equal amount is made and this stock is purchased

[32] Williams v. W. U. Tel. Co., 93 N. Y. 162 (1883).

[33] Howell v. Chicago, etc. Ry. Co., 51 Barb. 378 (1868); Gordon v. Richmond, etc. R. R., 78 Va. 501 (1884).

by the stockholders, their indebtedness therefor being offset by the dividends due them.[34]

In most of the states, however, no such restriction exists and stock dividends are not uncommon, and, under proper conditions, are not legally objectionable. If the directors wish to retain the corporate profits to increase the capital of the corporation, " it becomes immaterial whether such increase is made by awarding the stock to stockholders as dividends in lieu of money, retaining the money for the purposes of the company, or by paying the stockholders the dividends in cash from the earnings of the company and selling the stock in the market to raise money for the use of the corporation."[35] Or as stated in a later case, " So long as every dollar of stock issued by a corporation is represented by a dollar of property, no harm can result to individuals or the public from distributing stock to the stockholders. * * * All that can be required in any case is that there shall be an actual capital in property representing the amount of share capital issued."[36]

A stock dividend issued against actual corporate property of at least equal value is held to be full paid[37] but, if not so issued in good faith, is not.[38]

It will be observed that a stock dividend of the kind here considered is entirely different from that derived from " stock watering," in which the new stock does not represent profits at all but is merely a dilution of the existing capital and is illegal and objectionable.

§ 247. (b) **Bond Dividends.**

The corporate bonds may take the place of cash in payment of dividends at the discretion of the directors, provided only that they are issued against actual profits. The argument

[34] Jones v. Brown, 171 Mass. 318 (1898).
[35] Howell v. Chicago, etc. Ry. Co., 51 Barb. (N. Y.) 378 (1868).
[36] Williams v. W. U. Tel. Co., 93 N. Y. 162 (1883); Earl, J.; Rose v. Barclay, 191 Pa. St. 594 (1899).
[37] Kenton, etc. Co. v. McAlpin, 5 Fed. Rep. 737 (1880); Berwind-White Coal Co. v. Ewart, 11 Misc. (N. Y.) 490 (1895).
[38] Shaw v. Gilbert, 111 Wis. 165 (1901).

for their issue is the same as for the issue of stock as dividends. If the company has profits available for dividends, it may take these profits for the corporate purposes and replace them with the bonds and distribute these bonds as dividends. The bond dividend is held legal when issued against actually existing corporate profits.[39]

From the practical standpoint it must, however, be observed that bonds carry interest which becomes a fixed charge against the company and must be paid thereafter whether profits are made or not. Also the bond itself is an absolute obligation of the company which must be paid at maturity. Both these features may be objectionable, and do not exist in the case of stock.

§ 248. (c) Scrip Dividends.

The favorite method of paying dividends when neither stock nor bonds are available or expedient, is by means of scrip. This is practically a deferred dividend, scrip being a certificate stating that the owner or holder is entitled to certain rights or privileges specified in the certificate,—usually a certain amount of cash payable at some fixed future date. In the issue of scrip dividends the same rule obtains as in the case of any other dividends. Profits either present or prospective must exist as a basis for their issue.

Usually scrip represents existing profits which are not in the form of money but which may be realized upon at some future date and the money then be used to pay off this scrip. Or there may be no intention that the corporate property shall be realized upon, the expectation being that at the time the scrip becomes due, cash will be on hand for its payment without regard to whether the property in question is sold or not.

Sometimes, however, scrip represents an absolute reservation of cash profits as in the case of the scrip dividend declared

[39] Wood v. Lary, 124 N. Y. 83 (1891); S. C., 47 Hun. 550; N. Y., etc. R. R. v. Nickals, 119 U. S. 296 (1886).

by the Erie Railroad in 1907. Here cash profits had supposedly been earned and were available to the extent of some millions of dollars. Dividends were due amounting to $1,915,696 on the first preferred stock and $640,000 on the second preferred stock. These amounts would ordinarily have been paid out in cash but the directors determined that this cash would be employed to greater advantage in betterments than in payment of dividends. They thereupon declared a dividend in scrip in lieu of cash, to the full amount of the dividends due upon both preferred stocks, the scrip to be payable in 1914 and to bear interest at the rate of four per cent. per annum until its due date.

A scrip dividend of this kind partakes much of the nature of a forced loan. The stockholders would undoubtedly prefer cash, but are compelled to take the long-time scrip assigned them. It may be noted that the rights to the Erie scrip were selling within a few days of the declaration of the dividend at a discount of from forty to fifty per cent. from face value.

The payment date on scrip may be made absolute as in the case of the Erie scrip just mentioned, or may be made contingent, as where it is provided that scrip shall be payable as soon as the company accumulates sufficient surplus funds for the purpose or when specific property upon which the scrip is based shall be sold.

Scrip is issued in many different forms. Sometimes the certificates are convertible, being exchangeable at a certain time for stock or bonds of the company on demand of the holder. Sometimes they are payable at a date certain; sometimes not until net profits are earned sufficient for the purpose or until the money for their payment is received from some specified source. At times scrip certificates entitle the holders to dividends as would stock to the same value. The scrip then par-

NOTE.—The Erie scrip dividend above referred to, though duly declared, had not been issued on the publication date of the present volume—March 2, 1908—authorization therefor having been refused by the Public Service Commission.

takes much of the nature of stock save that it has no voting power.

Scrip certificates, though issued as a dividend and in lieu of certain property in the possession of the corporation, do not fix the ownership of that property in the holders of the certificates. They do give the holders a claim against the corporation—not the absolute claim which the ordinary declared dividend gives, but a conditional claim dependent upon the terms of the scrip certificate. In the case of the Erie scrip referred to, the claim is absolute, both for interest, and, at the redemption period, for principal as well. It is in fact merely a deferred interest-bearing dividend.

Provided only that the principal and any interest to be paid on corporate scrip are either represented by corporate profits actually on hand, or are payable only from future profits, or profits for such payments actually exist at the time or will exist when the demands fall due, the scrip dividend is not legally objectionable.

§ 249. (d) **Property Dividends.**

Dividends may consist of actual property, though, except in the case of corporate securities, there are obvious difficulties in the way of distribution which make such dividends rare. Thus a company whose profits were in land, might divide this land among its stockholders as a dividend, if it could do so equitably, and no objection could be raised. The more usual form of property dividends is, however, that of securities of other corporations received, when the corporation sells property or rights of some kind to another corporation, taking the stocks and bonds of that other corporation in payment. Or securities may have been bought outright at some previous time from profits. The stock and bonds so received are then divided among the stockholders of the receiving company as dividends. There are no objections to such dividends provided they represent actual profits.

Usually, however, dividends of this kind are declared only when a corporation is liquidated, all its property perhaps having been exchanged for stock or bonds, or both, of the purchasing corporation. In this case the distribution is not, strictly speaking, a payment of dividends but is a distribution of assets, and the ordinary rule that dividends may be declared only from profits does not apply.

CHAPTER XXV.

DIVIDENDS.—(Continued.)

§ 250. Declaration of Dividends.

> "The Board of Directors may declare dividends from the surplus or from the net profits of the Company.
>
> "The dates for the declaration of dividends upon the preferred stock and upon the common stock of the Company shall be the days by these By-laws fixed for the regular monthly meetings of the Board of Directors in the months of April, July, October and January in each year, on which days, the Board of Directors in its discretion shall declare what, if any, dividends shall be declared upon the preferred stock and the common stock, or either of such stocks.
>
> "The dividends upon the preferred stock, if declared, severally and respectively, shall be payable quarterly upon the thirtieth day of May, of August, of November and the last day of February in each year.
>
> "The dividends upon the common stock, if declared, severally and respectively, shall be payable quarterly on the thirtieth day of June, of September, of December and of March in each year.
>
> "If the date herein appointed for the payment of any dividend shall in any year fall upon a legal holiday, then the dividend payable on such date shall be paid on the next day not a legal holiday."[1]

In the smaller corporations the by-laws regulating dividends are much more general in their provisions, usually merely restating the common or statutory law on the subject, as in the following extract:—

[1] By-Laws of the U. S. Steel Corporation, Art. VI, § 5, "Dividends."

> "Dividends shall be declared only from the surplus profits at such times as the Board shall direct, and no dividend shall be declared that will impair the capital of the Company."

Under this by-law, the directors have wide discretion and, provided no statutory provisions conflict, may reserve any profits they please for surplus or working capital, or may declare any legally available profits as dividends, and so long as the exercise of their discretion is honest, can neither be restrained nor compelled.

Statutory provisions prohibiting dividends that will impair the capital stock or that will render the corporation insolvent, are found in practically every state of the Union. It is but seldom that the statutes go further in respect to dividends.

The by-laws frequently regulate the declaration of dividends. In some cases they provide that a specified surplus fund shall be reserved before any dividends may be declared. In other cases they specify that after the reservation of a designated surplus, any remaining profits shall be declared as dividends. Occasionally the matter is reversed, the by-laws requiring that dividends to a specified amount shall be declared before any profits may be reserved as surplus. Such a by-law provision is, as a rule, obviously undesirable as it compels the declaration of dividends regardless of the business conditions which should control.

Usually before the date fixed for declaration of dividends, or, if no such date is fixed, at the time a dividend is contemplated, the treasurer is called upon for a statement showing the corporate profits available for the purpose. If, however, the corporation has ample surplus profits, or if the business is so prosperous as to obviously justify the proposed dividend, no statement is necessarily required, the directors merely declaring the dividend as a matter of course.

When the fact and the amount of the dividend have been decided upon, a formal resolution declaring it is adopted by the directors. This resolution usually fixes specifically the amount of the dividend and states to whom and when it shall be paid. The amount is ordinarily expressed as a percentage upon the par value of the stock, though sometimes as a fixed amount per share. The recipients must necessarily be stockholders of the company but are usually stockholders of a specified future date, and the time of payment is usually fixed at a still later future date.

Thus a semi-annual dividend declared by the Pennsylvania Railroad Company November 1st, provides for a payment of three and one-half per cent. upon the capital stock of the company, payable on and after November 30th, to stockholders as registered upon the books of the company at the close of business November 4th. In the notice of this dividend, the statement of the amount on each $50 share, i. e. $1.75 per share, is also included.

In this case the dividend is absolutely fixed and irrevocable on the first of November but is not actually effective or due until the thirtieth of November, and is to be then paid to those who were stockholders of record at the close of business on November 4th. Stock transferred before that date carries the dividend with it. Stock transferred after that date does not unless by express agreement, the right to the dividend having passed to the individual stockholders of record on November 4th.

The directors have full power to declare a dividend effective at any future date they please. They cannot, however, antedate it. Thus the directors could not on January 1st, 1908, legally declare a dividend payable to stockholders of record on the 15th of the preceding October.[2] The power to do so would, it is obvious, open a wide door for injustice and fraud.

If the treasurer is a member of the board or is present at the board meeting, the passage of the resolution declaring the

[2] Jones v. Terre Haute, etc. R. R., 57 N. Y. 196 (1874).

dividend is undoubtedly sufficient notice to him of the fact and he is then fully authorized to carry the resolution into effect.

If the treasurer is not present at the board meeting, a verbal statement made to him by a member of the board or by the secretary of the company is a common, but, in itself, hardly sufficient notice of the board's action. A personal inspection of the resolution entered in the secretary's minutes is better, and, though informal, is sufficient. Written notice from the secretary of the passage of the resolution, with a copy of the resolution itself incorporated, is more formal and may, if he choose, be demanded by the treasurer. As soon as the treasurer has authoritative notice of the resolution, no matter how his knowledge is derived, he may proceed at once to the payment of the dividend in accordance with its terms.

The resolution declaring a dividend usually provides for the closing of the stock books to transfers of stock for a certain period before the dividend day, i. e., the day when the dividend is to be paid. This provision for closing the transfer books is usually and properly part of the charter or by-law requirements of the corporation. It is questionable whether the directors would have power to close the transfer books unless so authorized.

§ 251. Notice of Dividends.

The directors of a corporation have full power to fix the time and place of payment of dividends, if reasonable and in good faith, but they must give stockholders due notice.[3]

When dividend checks are not mailed, notice must be given the stockholders of the time and place at which dividends will be paid. These notices are sent out by the treasurer or the secretary, according to the regulations of the particular corporation. The officer sending the notices must be governed absolutely by the stock book, unless he has personal knowledge or has received formal notice of the fact that some particular

[3] King v. Paterson, etc. R. R. Co., 22 N. J. L. 87 (1860).

stockholder of record is not the stockholder in fact. The party to whom the dividend is to be paid is always the proper party to notify. If there is doubt in any particular case as to whom a dividend is to be paid, responsibility may be avoided by sending notices to all the parties interested, leaving the ownership of the dividend to be settled later.

In some of the larger corporations, notice of a dividend and the time and place of payment and the period for which the stock books are closed, is usually mailed to every stockholder and is published in the newspapers as well—this latter not entirely as a legal requirement but as a general notification to the stockholders and to the general public as well that the corporation is paying dividends. The publication of the dividend notice is presumptive proof of notice to the stockholders but is not alone conclusive. If the stockholders see the notice, it is sufficient, but if any particular stockholder does not happen to see the newspaper announcement, he cannot be held to have received notice and the corporation is liable for any resulting loss.

Thus a dividend had been declared and the amount required to pay it was deposited in a certain bank, where the stockholders were to call and receive payment upon signing the dividend book. Notice of the time and place of payment was published in the daily newspapers. One stockholder failed to see the notice, did not call, and the bank failing some seven months later, his dividend was lost. He thereupon brought suit against the corporation and recovered its amount, the newspaper notice being held insufficient.[4]

At the present time corporations when paying dividends usually mail checks to the stockholders, and this, if properly done, avoids any possibility of failure of notice. The dividend checks are nothing more than orders upon the bank for payment of the amount due the stockholder, but the recipient of such a check has in the check itself sufficient notice of the

[4] King v. Paterson, etc. R. R. Co., 22 N. J. L. 81 (1860).

time and place for the payment of his dividend. Where checks are mailed, a newspaper notice of dividends is usually deemed entirely sufficient.

Dividend notices are frequently signed and issued by the secretary but more commonly are issued over the signature of the treasurer.[5] The legal effect is the same in either case.

§ 252. To Whom Paid.

A stockholder of record is one whose name appears upon the stock books of the corporation as an owner of its stock. Dividends are ordinarily payable to those who at the time the dividend becomes effective are stockholders of record. The stock book, therefore, at this time, shows to whom the dividend must be paid.

The rule is not, however, invariable. It may be that stock is pledged and the pledgee has not had the stock transferred to his own name, though dividends are payable to him. Or occasionally it happens that stock has been sold before the declaration of the dividend, but the transfer through neglect or other cause, has not been recorded on the books. The equitable ownership of the stock and the right to the dividend then vests in the party to whom the stock has been assigned, but the ownership of record still remains in the former owner.

The treasurer, in the absence of notice, has no concern as to these equitable owners. The stock books of the corporation are conclusive for his purposes until their evidence is impeached by the presentation of duly assigned certificates, or other satisfactory evidence of a different ownership or by information that would put the corporation "on notice." Therefore, even though it proves later that the holder of record is not the rightful owner of the dividend, the treasurer and the corporation are protected in payments made according to the unimpeached record of the stock books. They have

[5] See Chapter XXXV., "Dividend Notices."

used all reasonable care and cannot be held for the results of negligence on the part of others.[6]

If, however, the treasurer or the corporation receives notice of some unrecorded transfer involving the ownership of the dividend, i. e. a transfer made before the dividend became effective or perhaps thereafter with an assignment of the dividend, he is bound to take notice of the facts and pay the dividend to the rightful owner.[7]

As the stock books, if unimpeached, control absolutely, the production of a stockholder's certificate of stock is not necessary, nor can it be required to prove either his ownership of stock or of dividends, if this ownership is shown by the stock books. If the true ownership is not so shown, the duly assigned certificate is good evidence thereof and sufficient to justify the treasurer in paying the dividend to the owner of the certificate, provided only that the assignment was made before the effective date of the dividend.

The conclusive nature of the unimpeached stock books and the function of stock certificates in dividend matters are clearly brought out in a case[8] where stock had been sold by the owner of record and the sale was evidenced by a duly assigned certificate, but for years was not entered on the books of the company. The stockholder of record died before the transfer was recorded and his administrator discovering the estate's apparent ownership of this stock and not finding the certificate representing it, filed a bond of indemnity with the corporation, secured another certificate and thereupon received dividends on the stock in question for a term of years. Finally the original, duly assigned certificate of stock turned up in the hands of the transferee, who not only demanded transfer of the stock on the books of the corporation but payment of all dividends declared upon his stock from the date of its assign-

[6] Cleveland, etc. R. R. v. Robbins, 35 O. St. 483 (1880).

[7] Rose v. Barclay, 191 Pa. St. 594 (1899).

[8] Brisbane v. Del., etc. R. R., 94 N. Y. 204 (1883).

ment to him, and upon a refusal, brought suit against the corporation to enforce his demands.

The courts promptly confirmed his rights to a transfer of the stock on the books of the corporation, but as promptly refused to hold the corporation responsible for the lost dividends, stating that " the books containing the lists of the stockholders are evidence of the ownership of the stock and a corporation is justified in being governed thereby until proof or notice is given showing that other parties than those named therein are the owners of the stock." Also as to dividend payments to the stockholder of record, " His title as it appeared on the books was conclusive until impeached and the defendant was bound to pay the same unless it had some notice of a change of the title or of a transfer of the stock, or such knowledge or information as would put it on inquiry as to the ownership thereof." In such a case the equitable owner has no claim against the corporation but must proceed against the owner of record to recover his dividends.[9]

If there is any real doubt as to whom a dividend is properly payable, the treasurer's only safe course is to withhold payment until the matter is satisfactorily settled by the parties themselves, or until the ownership of the dividend is determined by proper legal procedure. This litigation may involve only the disputants but may also be directed against the corporation. If in any case the corporation is likely to suffer, it may interplead and ask the court to decide to whom the dividend belongs.

In case stock stands in the name of a married woman, the treasurer must pay the dividends declared thereon to the wife or to the husband according to the requirements of the state in which the corporation is chartered.[10] In most states of the Union dividends are payable to the wife when stock stands in her name.

[9] Houser v. Richardson, 90 Mo. App. 134 (1901).

[10] Graham v. First Nat. Bank of Norfolk, 84 N. Y. 393 (1881).

If stock is pledged, the pledgee is entitled to any dividends declared meanwhile even though he is not a stockholder of record, provided the corporation has had due notice of the pledge. But the pledgee must account for these dividends to the pledger when the pledge is redeemed.[11]

If a corporation holds stock of other corporations, it is entitled to receive dividends on this stock as is any other stockholder. It cannot, however, pay dividends on its own stock held in the treasury of the corporation. When dividends are payable to a corporation the dividend check may be made either in the name of the corporation, or to the treasurer as treasurer of the corporation. If stock belongs to an estate, payment of dividends should be made to the administrator. If, however, the stock passes to a legatee, all dividends declared after the date of the testator's death belong to the legatee, but if any dividends have been declared before that date but are not yet paid, they will belong to the general estate.

§ 253. Payment of Dividends.

It is customary to close the stock books a certain number of days before a dividend is to be paid, in order to give the treasurer an undisturbed opportunity to make up his dividend statement from the books. The "closed" period usually begins on the effective date of the dividend and continues until the date of its payment, or if this period is lengthy, for such reasonable time as will enable the treasurer to secure from the books the data he requires for his dividend statement. During this period no transfers of stock will be made.

As a rule the closing of the transfer books works no hardship. They are not usually closed until the day on which the dividend is effective. Transfers of stock made after that date do not, therefore, carry the dividend, unless by special agreement between the parties, and the fact that the transfer cannot be immediately recorded is in most cases immaterial.

[11] II Cook on Corps., § 468.

If transfers prior to the declaration of the dividend have not been recorded, they are, of course, shut out, and to secure the dividend which rightfully belongs to such unrecorded stockholders, they must file due notice and evidence of the facts with the treasurer.

As soon as the stock books are closed, the treasurer is furnished by the secretary with a list of the stockholders of record as they appear on the date of closing, or otherwise the stock books are turned over to him and he secures the names and the addresses of the stockholders himself. The treasurer then makes up his dividend statement, showing the amount of stock held by each stockholder and the amount of dividends due him. The checks for dividends are made out and on the appointed date are mailed to the parties to whom they are due, or if dividend checks are not mailed, the stockholders are notified to call and receive their dividends in person.

In the smaller corporations the dividend check is usually nothing more than the ordinary check of the corporation, either marked or stamped "Dividend Check," or accompanied by a brief notice stating that the check is in payment of the specified dividend. In the larger corporations special checks are usually printed, with the words "Dividend Check" or "Dividend No. ——" or some other identifying phrase appearing on the face of the check. (See Form 10.)

Where the stockholders call in person for dividends, they are usually required to sign the regular receipt form upon the dividend book. If the checks are mailed, receipt forms are sometimes sent with them, to be signed and returned by the stockholders. Usually and preferably, however, the check itself is deemed an all sufficient receipt. When stamped "Dividend No. ——" or with some equivalent identifying phrase, as is usually the case, and endorsed by the recipient as must be done before the check can be collected, and stamped or cancelled by the drawee bank when paid, the check itself undoubtedly does afford the best possible evidence of the payment of the dividend. The check is usually accompanied by a notice either that a receipt is or is not required, as the case may be.

The dividend check is in no wise different in its nature from any other corporate check. It should be deposited or otherwise presented for payment promptly and if this is not done, the recipient must bear any loss accreditable to such delay in presentation. The dividend check is also subject to all the usual customs and requirements relating to checks, as set forth in preceding chapters.

§ 254. Compelling Declaration of Dividends.

As already stated, the charter or by-laws of the company may provide more or less specifically as to when or under what condition dividends shall be declared, and as long as such requirements are in harmony with the state laws, the directors must observe them. If they do not, the stockholders may compel such observance by legal procedure.

In the absence of any such provisions or within their limits, the directors have wide discretion as to dividends. They are responsible for the proper management of the corporation and, particularly in the matter of dividends, are held to strict accountability by the law, and they are therefore entitled to the free exercise of their judgment as to when and to what amount these dividends shall be declared.

" As a general rule the officers of a corporation are the sole judges as to the propriety of declaring dividends and the courts will not interfere with the proper exercise of their discretion."[12] " When a corporation has a surplus, whether a dividend shall be made and how much it shall be and when and where it shall be payable, rests in the fair and honest discretion of the directors uncontrollable by the courts."[13] "The courts have, no doubt, in many cases overruled the directors who proposed to pay dividends, but I am not aware of any case in

[12] Belfast, etc. R. R. v. Belfast, 57 Me. 445 (1885).
[13] Williams v. W. U. Tel. Co., 93 N. Y. 162 (1883).

which the court has compelled them to pay when they have expressed their opinion that the state of the accounts did not admit of any such payment. In a matter depending upon evidence and expert opinion it would be a very strong measure for the court to override the directors in such a manner.[14]

Even where there is a specific agreement to pay dividends or interest out of profits and profits exist, the courts are slow to enforce the agreement. Thus in a case of this kind it was held: " There must be profits adequate not only for the payment of the claims of the plaintiffs in the cause, but for the payment of all other stockholders having like claims, and there must be a surplus fund over and above what was requisite for the payment of current expenses, for discharging amounts due creditors, and over and above what reasonable prudence would require to be kept in the treasury to meet the accidents, risks and contingencies incident to the business of operating a railroad."[15] In this case the court decided in favor of the stockholders but in a very similar case[16] the decision was adverse.

While the courts are reluctant to compel dividends, there is a point at which they will intervene to prevent undue or improper retention of profits. " The directors must act in good faith. If they fail to do so and it clearly appears that they have accumulated earnings not required in the prosecution of the business which they withhold from the stockholders for illegitimate purposes, a court of equity may interfere and compel a distribution of such earnings."[17] " Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to

[14] Bond v. Barrow, etc. Co., 86 L. T. Rep. 10 (1902); Farlow, J.

[15] Richardson v. Vt., etc. R. R., 44 Vt. 613 (1879).

[16] Park v. Grant, etc. Works, 40 N. J. Eq. 114 (1885).

[17] Matter of Rogers, 161 N. Y. 108 (1899).

such an abuse of discretion as would constitute a fraud or breach of that good faith which they are bound to exercise towards the stockholders."[18]

Cases sometimes arise, however, where a refusal to declare dividends, even where apparently reasonable on its face, is inequitable because of the conditions. For instance, preferred stock not infrequently carries non-cumulative dividends and if these dividends are not declared in any year, they are lost to the preferred stock entirely. It is obvious, then, that if profits exist from which the dividends might be paid but the directors instead of declaring these dividends, carry them over in surplus until the following year, the preferred stock has been juggled out of a dividend that properly belongs to it and there is a distinct advantage to the holders of the common stock.

Thus if a company has a capitalization of $200,000, of which $50,000 is preferred non-participating stock carrying a seven per cent., non-cumulative dividend, and the remainder is common stock, and the directors pay no dividends for five years although profits sufficient to pay the preferred dividends were made, these dividends, amounting to $17,500, are lost absolutely to the preferred stock. Then in the sixth year, the directors, should they so desire, might declare a seven per cent. dividend on the preferred stock amounting to $3,500, which is all the preferred stock is entitled to for that year, and thereafter declare the entire remaining profits as a dividend on the common stock. This latter then receives $14,000 that really belongs to the preferred stock.

In cases of this kind the courts are much less reluctant to intervene and will usually compel payment of the dividends on the preferred stock for any year if satisfactory proof is adduced that profits exist sufficient for the purpose, which can be used without injury to the corporation. Even here, however, the court scrutinizes the condition of the corporation closely and refuses the dividend unless it is clearly and unmis-

[18] Hunter v. Roberts, Throp & Co., 83 Mich. 63 (1890).

takably withheld wrongfully and to the injury of the preferred stock.[19]

§ 255. Illegal Dividends.

The declaration of an illegal dividend or the payment of an illegal dividend already declared may be enjoined and stopped by proper action of the stockholders.

Illegal dividends may be of three characters:—

(1) Those declared in disregard of the rights of some of the stockholders.

(2) Dividends declared in violation of charter or by-law provisions of the particular corporation.

(3) Those which either impair the capital stock or threaten the insolvency of the corporation.

(1) Dividends which are unequal among stockholders of the same class are absolutely in disregard of the rights of the stockholders discriminated against,[20]—so much so that cases directly involving the principle but seldom arise. When inequalities are attempted it is usually by means of diversions of the profits, such as payments of excessive salaries or unnecessary expenditures.

Another instance of dividends in disregard of the rights of stockholders is sometimes found when the directors declare dividends on common stock while cumulated dividends due on preferred stock have not been paid. In such case the courts will compel a readjustment of the dividends.[21]

(2) Dividends declared in violation of charter or bylaw provisions may be perfectly proper in themselves but illegal merely because of their prohibition. Thus the charter or by-laws may provide that no dividend shall be declared until after surplus funds have been accumulated to some specified amount. Then if dividends are declared before this surplus

[19] Belfast, etc. R. R. v. Belfast, 77 Me. 445 (1885).

[20] See § 242.

[21] Luling v. Atl. Mut. Ins. Co., 45 Barb. 510 (1865).

has been reserved, they are illegal and payment may be enjoined by proper action of the stockholders.

(3) The most common form of illegal dividends is that which impairs the capital stock or which endangers the solvency of the corporation. In a case of this kind it is to some extent a matter of bookkeeping and judgment as to whether a dividend is such as to impair the capital stock or render the company insolvent. If the directors declare a dividend in good faith, after a proper investigation of the financial condition of the company, the courts are not likely to interfere.

A case of illegal dividends comes within the jurisdiction of courts of equity and any stockholder may bring suit therein to enjoin the declaration of a dividend believed by him to be illegal. If the dividend has been declared but not paid, all the stockholders must be joined as parties. An illegal dividend may be rescinded by the directors at any time before its payment.

§ 256. Liability for Illegal Dividends.

In most of the states a liability is imposed upon the directors by statute for any violation of the laws regulating dividends. In some cases offending directors are made liable for any and all debts of the corporation incurred during their term of office. In other cases they are liable only for the amount actually paid out in these illegal dividends. In some states they are not only held liable for the corporate debts, or for restitution in case of dividends illegally declared, but are also guilty of a misdemeanor punishable by fine and imprisonment.

As a rule, the treasurer is not personally liable in any way for the payment of dividends ordered by the directors unless he knows such dividends to be absolutely fraudulent. In a few states, however, liability for dividends prohibited by statute has been extended by express enactment to the executive officers of the corporation if they consent thereto or concur therein. In such states, if the treasurer knowing the dividends to be in violation of the statutory provision, nevertheless obeys the instructions of the directors and either pays such dividends or permits them to be paid, he is liable with the directors. There are, it may be said, but few states in which this liability exists.

If the directors of a corporation declare a dividend in violation of its charter or by-law provisions, they may be enjoined from its payment, or if not, would undoubtedly be held liable for any resulting damage to the corporation.

When dividends are declared which impair the capital stock or render the corporation insolvent, they not only subject the directors to liabilities and in some cases penalties, but such illegal dividends may be recovered from the stockholders to whom they were paid. "It is the well determined doctrine of the courts of this country that the capital stock is a fund to be preserved for the benefit of corporate creditors. Hence the rule has been firmly established that where dividends are paid in whole or in part out of the capital stock, corporate creditors being such when the dividend was declared or becoming such at any subsequent time, may to the extent of their claims, if such claims are not otherwise paid, compel the shareholders to whom the dividend has been paid to refund whatever portion of the dividend was taken out of the capital stock. * * * "

" If a dividend has been paid out of the capital stock, the stockholders are conclusively presumed to have known it and are liable to an action for repayment. They cannot claim to hold the position of innocent or bona fide holders."[22]

§ 257. Treasurer's Liability as to Dividends.

As already said, in some few states the officers are together with the directors liable for dividends paid in violation of statutory provisions. As a rule, however, the declara-

[22] Cook on Corps., § 548.

tion and payment of dividends is one so entirely within the province and discretion of the board that the treasurer is not held liable for any dividends paid in accordance with the board's directions, unless they should be absolutely fraudulent.

The treasurer usually furnishes to the directors the statement of the corporate accounts and finances which determines whether or no dividends shall be declared. It is his duty to provide an accurate statement and should his presentment be so erroneous or so carelessly compiled as to mislead the directors and cause the declaration and payment of improper dividends, he would have failed in the " due diligence " and reasonable care exacted of the treasurer as an agent of the corporation and would be liable for any resulting loss.

Beyond this the treasurer is also responsible for the proper payment of dividends, not only as to the actual computation of amounts due and the proper drawing of the dividend checks, but for their delivery to the proper persons.[23]

[23] See § 252.

PART IV.—NEGOTIABLE INSTRUMENTS.

CHAPTER XXVI.

NATURE AND REQUISITES.[1]

§ 258. Laws which Govern.

The rules governing negotiable instruments differ in material respects from those applying to other contracts. These rules were originally found in the "Law Merchant," i. e., the common law applying to commercial transactions, but have been re-enacted with numerous local variations and additions in the statutes of every state in the Union. The result of these local differences, together with varying judicial interpretations of many important points, was to render the law governing negotiable instruments complicated and difficult.

These complexities gave rise to what is termed the "Negotiable Instruments Law." This is a code of law compiled for the express purpose of unifying and simplifying the rules governing such instruments. It incorporates all the essential features of the common law as far as they apply to negotiable instruments and has been formally enacted or adopted as the statute law in some thirty states of the Union. In these states the requirements as to negotiable instruments are practically uniform.

[1] The sectional references in the text of the present and following chapters of Part IV are to the Negotiable Instruments Law as enacted in New York. In other states in which the Negotiable Instruments Law has been enacted, the substance of the law is the same but the sectional numbers under which it appears vary.

The Negotiable Instruments Law has been adopted in the following states and territories: Arizona, Colorado, Connecticut, District of Columbia, Florida, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Missouri, Montana, New Jersey, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Virginia, Washington, Wisconsin and Wyoming. In 1907 it was also adopted in Illinois, New Mexico and West Virginia.

The benefit arising from uniformity of requirements in the different states on so important a subject as negotiable instruments is obvious and the ultimate adoption of the Negotiable Instruments Law in every state of the Union seems assured.

By the provisions of the Negotiable Instruments Law all other statutory laws regulating negotiable instruments are repealed where it is adopted but the common law still applies as to matters not provided for by the code. (§ 7.) In the states where the Negotiable Instruments Law has not been adopted, the statutes and common law control, the statutes being superior to the common law upon all points of conflict. The present discussion follows in the main the principles laid down in the Negotiable Instruments Law.[2]

§ 259. What Constitutes a Negotiable Instrument.

A negotiable instrument is an undertaking for the payment of money, of such nature and legal status that its title may be transferred by mere endorsement and delivery or by delivery alone and against which when in the hands of a holder in due course,[3] the defenses of an ordinary contract do not prevail. The negotiable instruments most commonly employed in commercial transactions are bills, notes and checks.[4]

The special features of negotiable instruments to which they owe their utility in commerce and in which they differ from ordinary instruments of agreement are as mentioned above,—(a) the very simple methods of transfer; (b) the untrammelled nature of the rights of enforcement transferred.

§ 260. (a) Methods of Transfer.

A negotiable instrument, when payable to some specific person or his order, is transferred or negotiated by mere

[2] In the preparation of Part IV of the present volume, Crawford's Annotated Negotiable Instruments Law has been freely used. Mr. Crawford, the author of the work mentioned, is the compilor of the original code which formed the basis of the Negotiable Instruments Law.

[3] See § 274.

[4] See Chaps. XXII and XXIII, "Checks"; Chap. XXIX, "Bills and Notes."

endorsement of the payee's name followed by delivery of the instrument to the transferee, who is then known as the endorsee and to whom the instrument is then payable. If the instrument is payable to bearer, or some indefinite expression is used as "Pay to Cash," the instrument is transferred by mere delivery and the ownership vests in any lawful holder. (§ 60.) An ordinary contract or agreement, on the contrary, can only be transferred by formal assignment, and possession alone gives no title.

§ 261. (b) Rights Transferred.

When a negotiable instrument, complete and regular on its face, is transferred to a third party who takes it in good faith and for a valuable consideration and before maturity of the instrument, such third party is entitled, in accordance with its terms, to payment of the full amount of money called for by such instrument, and this regardless of any agreements between the original parties, whether written or verbal, or any defenses that would be effective as to an ordinary contract. (§ 90.) Under these conditions the position of the transferee as to and his interest in the instrument may be very different from that of the transferrer.[5]

For instance, stock is purchased on the representation that the issuing company is prosperous and the stock valuable, the purchaser giving his note in payment therefor. Before the note matures he finds that he has been deceived, the company which issued the stock being practically insolvent and the securities of no value. The consideration for which the note was given has therefore failed.

Under such circumstances the purchaser may refuse payment of his note on the ground of this failure of consideration and the defense is sufficient if the note is still in the hands of

[5] G. N. Bank v. Bingham, 118 N. Y. 349 (1890).

the party to whom it was given.[6] The note is then as valueless as the stock.

If, however, before its maturity the note was transferred to a third party who takes it in the ordinary course of business and without knowledge of the failure of consideration, the peculiar nature of negotiable paper comes into play, and, as to him, the failure of consideration is no defense. In his hands the note is valid and he can compel the drawer to pay the full amount called for by the note regardless of the hardship thereby inflicted. (§ 96.)

This absolute value in the hands of an innocent third party, in most cases entirely independent of the conditions under which the instrument was given, is peculiar to negotiable instruments.

§ 262. Requisites of Negotiable Instruments.

"Negotiable paper must carry its full history upon its face."[7] In other words, the note, draft or check goes out with all its conditions expressed upon the instrument. No agreements between the original parties are of any effect as to a third party unless they are written in or are attached to the instrument itself.

The language of a negotiable instrument is immaterial and any terms are sufficient which indicate its purpose with reasonable clearness. It must, however, conform to certain general requirements of the law. These are as follows:

(a) It must be in writing. If printed or partially printed and partially written, the requirements of the statutes are satisfied. (§ 20.)

(b) It must be signed by the maker or drawer, as the case may be. (§ 20.) The name may be written in ink or pencil, be indicated by marks, or be even printed but in this latter case it is not self-proving as is the written signature.

[6] Breneman v. Furniss, 90 Pa. St. 186 (1879).

[7] Daniel Neg. Insts., § 30.

Attestation of signature is not necessary save in the case of a signature indicated by marks, in which case for convenience in proving it should be witnessed.[8]

(c) Its undertaking must be the payment of money. (§ 20.) This requirement is, however, somewhat modified in some of the states, either by statute provision or by decisions of the courts. Thus in New York certain warehouse receipts are held to be negotiable paper; in Wisconsin warehouse receipts, bills of lading and railroad receipts are negotiable unless otherwise marked, and in Georgia certain instruments, though payable in goods, are by special enactment declared negotiable.

(d) No undertaking beyond the payment of money must be required. This does not, however, prevent the inclusion of provisions—unless in violation of the statute law or policy of the state—which (1) authorize the sale of collateral security in case the instrument is not paid at maturity,[9] or (2) authorize a confession of judgment if interest is not paid at maturity, or (3) waive the benefit of any law intended for the advantage or protection of the obligor, or (4) give the *holder* an election to require something else than money, as goods or land or labor.[10] (§ 24.)

(e) The amount must be certain. (§ 20.) In any case where the amount of the instrument is not specified with exactness or so expressed that it can be definitely determined, the instrument is not negotiable. This does not preclude provisions requiring the payment of interest or exchange, for the amount of these can be definitely ascertained; nor for collection and attorneys' fees in case of non-payment at maturity, nor for payment by instalment. (§ 21.) In some states, however, provisions for attorneys' fees are void[11] but do not

[8] See § 264.

[9] Perry v. Bigelow, 128 Mass. 129 (1880).

[10] Hodges v. Shuler, 22 N. Y. 114 (1860).

[11] Levens v. Briggs, 21 Oregon 333 (1891).

affect the negotiability of the instrument in which they are found.

(f) The undertaking must be unconditional. (§ 20.) If a note, the promise to pay must be absolute. If a draft or check, the order must be unqualified. If in any case conditions are inserted which render it uncertain whether the instrument will be finally paid, the negotiability of the instrument is destroyed. This does not preclude an indication of the particular fund from which payment is to be made, or the account to be debited, unless it is so precise as to limit the payment to that particular fund or account;[12] nor a statement of the transaction which gives rise to the instrument,[13] as none of these affect the unconditional nature of the order. (§ 22.) If, however, the order or promise is to pay out of a particular fund, or in case goods are delivered, or if some event occurs, the instrument loses its unconditional character and is no longer negotiable.[14]

(g) It must be payable at a determinable time. (§ 20.) This does not preclude a provision that upon default in payment of any instalment or of interest the whole shall become due. (§ 21.) If no time is expressed, the instrument is payable on demand,[15] but if some time is fixed, a time that will certainly come is requisite. The exact time or date of payment may be stated or may be indicated, or payment may be required on or at a fixed time before or after some specified future event, if this event be of such a nature that it must certainly happen, as " sixty days after my death."[16] If, however, the specified time of payment is one which may never arrive, as " sixty days after my marriage," the instrument is non-nego-

[12] Redman v. Adams, 51 Me. 433 (1863); Schmittler v. Simon, 101 N. Y. 554 (1886); Munger v. Shannon, 61 N. Y. 251 (1874).

[13] Mott v. Havana Nat. Bank, 22 Hun (N. Y.) 354 (1880); Bank v. Bowman Spring, 50 App. Div. (N. Y.) 66 (1900).

[14] Nat. Sav. Bank v. Cable, 48 Atl. Rep. (Conn.) 428 (1901).

[15] Messmore v. Morrison, 172 Pa. St. 300 (1896); Hall v. Toby, 110 Pa. St. 318 (1885).

[16] Cartwright v. Gray, 127 N. Y. 92 (1891).

tiable and the happening of the event does not cure the defect.[17]

(h) The instrument must be payable either to the order of some specified person or to bearer. (§ 20.) If the instrument is made payable " to Holder," " to Order " or to some indefinite term or fictitious name, it is held to be payable to bearer. (§ 28.) If no definite payee is named or indicated with reasonable certainty, the instrument is fatally defective. If the instrument is payable to some specified person but not to his order or to bearer, it is not negotiable.[18]

(i) In case of a draft or check, the drawee must be indicated with reasonable certainty. (§ 20.) So long as the party intended can be discovered from the description or indications of the instrument, the conditions of this requirement are fulfilled.

(j) The instrument must be delivered.

§ 263. Delivery.

The contract of a negotiable instrument is incomplete and revocable as to immediate parties until the instrument is delivered for the purpose of giving effect thereto by or under authority of the maker, drawer, acceptor or endorser, as the case may be. But whenever the instrument is in the hands of a holder in due course, a valid delivery is conclusively presumed. (§ 35.) Under this provision, a note or draft, if it be complete, is valid in the hands of an innocent third party, even though it were stolen or obtained by fraud from the original parties.

The possession of an instrument is always *prima facie* evidence of title[19] and a valid and intentional delivery by all parties whose names appear thereon is presumed until the

[17] Duffield v. Johnson, 96 N. Y. 369 (1884); First Nat. Bk. v. Alton, 60 Conn. 402 (1891).

[18] Maule v. Crawford, 14 Hun 193 (1878); Backus v. Danforth, 10 Conn. 297 (1834).

[19] Newcombe v. Fox, 1 App. Div. (N. Y.) 389 (1896).

contrary is proved. (§ 35.) But where an incomplete instrument which has not been delivered, is completed and negotiated without authority, it will not be a valid contract as against any person whose name was placed thereon before delivery.[20] (§ 34.)

§ 264. Signature.

The instrument must be signed. (§ 20.) As a general rule only those persons are bound whose names appear on the instrument.[21] (§ 37.) But a person is bound who signs in a trade or assumed name (§ 37), or signs as an agent when not duly authorized thereto (§ 59), or who affixes his mark intending to be bound thereby.[22] A signature may be affixed by any duly authorized agent and the principal will be bound thereby (§ 38), the agent himself not being bound if it clearly appears that he signs in a representative capacity.[23] (§ 39.)

A forged signature is absolutely inoperative and no rights are gained or transferred thereunder.[24] (§ 42.)

§ 265. Consideration.

"Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value." (§ 50.) Failure of or want of consideration is no defense against an innocent holder for value but is good as between the original parties (§ 54) and may be shown by parol evidence. "Value is any consideration sufficient to support a simple contract." (§ 51.) Consideration need not appear on instrument (§ 25), save in cases where it is given

[20] Sedgwick v. McKim, 53 N. Y. 307 (1873); Davis Sewing Mach. Co. v. Best, 105 N. Y. 59 (1887).

[21] Mfrs., etc. Bank v. Love, 13 App. Div. (N. Y.) 561 (1897).

[22] De Witt v. Walton, 9 N. Y. 574 (1854); Brown v. Butchers' & Drovers' Bank, 6 Hill. (N. Y.) 443 (1844).

[23] Mfrs., etc. Bank v. Love, 13 App. Div. (N. Y.) 561 (1897).

[24] See § 272.

for patent rights or for speculation in farm products at fictitious prices, when it must appear and the instrument, though in the hands of third parties, is then subject to all the defenses of an ordinary contract. (§§ 330, 331.) An "accommodation party," i. e., one who lends the credit of his name without direct consideration therefor, is, notwithstanding this fact, liable to any holder for value (§ 55) as save for this rule the very purpose for which his signature was given would be defeated. But an accommodation endorser has the right to retract his endorsement at any time before negotiation of the instrument, unless rights for valuable consideration have in the meantime attached in others.[25] Corporations have no power to bind themselves as accommodation parties unless they are given such power by their charter.[26]

§ 266. Maturity.

A negotiable instrument is payable at the time fixed therein and, under the Negotiable Instruments Law, without days of grace. If the day of maturity falls upon Saturday, Sunday or a holiday, the instrument is payable on the next succeeding business day, except that demand instruments payable on Saturday may, at the option of the holder, be presented before twelve o'clock noon of that day if the entire day is not a holiday (§ 145) or be presented on the next business day.

When the instrument is payable at a fixed period after sight or some specified date or event, the time is determined by excluding the day from which the time is to begin to run and by including the date of payment. (§ 146.)

A promissory note matures when by its terms the principal becomes due, and defaulted interest does not invalidate the title of one who purchases in good faith before maturity.[27]

[25] Berkeley v. Tinsley, 88 Va. 1001 (1892).

[26] Nat. Park Bank v. Security Co., 116 N. Y. 281 (1889).

[27] Kelley v. Whitney, 45 Wis. 110 (1878).

But a note payable by instalments is overdue when the first instalment is overdue and unpaid.[28] A transfer on the day of maturity is before the instrument is overdue.[29]

§ 267. Non-Essentials. (§ 25.)

The validity and negotiability of negotiable instruments are not affected by the following considerations unless otherwise prescribed by local statutes.

(a) Absence or error of date. The date appearing upon an instrument, or upon any acceptance or endorsement thereon, is deemed *prima facie* a true date. If the instrument has no date, it is considered as of the date of delivery. (§§ 25, 36.) Any holder may insert true date of instrument when date is blank. (§ 32.) If the date of an instrument is an impossible one as "September 31st," the nearest date will be presumed, as in the instance cited, September 30th.[30]

(b) Antedate or postdate. Does not affect the validity of instrument unless done for an illegal or fraudulent purpose. The person to whom such an instrument is delivered takes it as of the date of delivery. (§ 31.)

(c) Omission of words "value received" or statement that a value has been given (§ 25) except in certain cases where the instrument has been given for patent rights or speculation in farm products at fictitious prices, when the consideration must appear. (§§ 330, 331.)

(d) Omission of place where drawn. (§ 25.)

(e) Omission of place where payable.[31] (Id.)

(f) Use of seal. (Id.) Under the law merchant it was fatal to the negotiability of an instrument to affix a seal. This rule has, however, been relaxed in later years as to seals appearing in connection with the signatures to such instru-

[28] Vinton v. King, 86 Mass. 562 (1862).

[29] Con. Nat. Bank v. Townsend, 87 N. Y. 8 (1881).

[30] Wagner v. Kenner, 2 Rob. (La.) 120.

[31] See § 291, "Place of Presentment."

ments, particularly as to instruments executed by corporations.[32] Under the Negotiable Instruments Law it is immaterial whether or no the instrument be sealed.

(g) Designation of payment in a particular kind of current money as "gold," "banknotes," etc. (§ 25.)

§ 268. Ambiguities, How Construed.

If the language of a negotiable instrument is ambiguous or is lacking, the following rules of construction apply:—

(a) If there is a discrepancy between the sum payable as expressed in words and in figures, the sum denoted by the words controls, but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount.

(b) If the instrument provides for interest without specifying the date from which it runs, the interest will run from the date of the instrument or if the instrument is undated, from the issue or delivery thereof.

(c) If the instrument is not dated, it will be considered as of the date of issue.

(d) If there is a conflict between the written and printed provisions of an instrument, the written provisions will prevail.

(e) If the terms of the instrument are so ambiguous that there is doubt as to whether it is a bill or a note, the holder may treat it as either at his option.

(f) If a signature is so placed upon the instrument that it is not clear as to the capacity in which the person affixing the signature intended to sign, he is to be deemed an endorser.

(g) If an instrument contains the words "I promise to pay" and is signed by two or more persons, they are taken to be jointly and severally liable thereon. (§ 36.)

[32] Chase Nat. Bk. v. Faurot, 149 N. Y. 532 (1896); Weeks v. Esler, 143 N. Y. 374 (1894).

§ 269. Blanks in Instruments.

If an instrument is wanting in any material particular, the person in possession thereof has a *prima facie* authority to complete it by filling up the blanks. Thus if an instrument payable at a fixed period after date or acceptance has not been dated, the true date of issue or acceptance may be inserted by any legal holder and the instrument is payable accordingly. Or if the place for name of the payee is left blank, the holder may fill in his own name as payee.[33] Or a complete instrument may be drafted over the signature of a person written for the purpose on blank paper.[34] But such implied authority only extends to the completion of the instrument in accordance with the intention of the original parties.[35] If wrongly filled, however, the instrument will still prevail in the hands of any *bona fide* holder for value.[36] (§ 33.)

[33] Boyd v. McCann, 10 Md. 118 (1856).

[34] Frank v. Lilienfeld 33 Gratt. (Va.) 377 (1880); Elliott v. Chestnut, 30 Md. 562 (1869); Androscoggin Bank v. Kimball, 10 Cush. (Mass.) 373 (1852).

[35] Weyerhauser v. Dun, 100 N. Y. 150 (1885).

[36] Redlich v. Doll, 54 N. Y. 234 (1873); Van Duzer v. Howe, 21 N. Y. 531 (1860); Elliott v. Chestnut, 30 Md. 562 (1869).

CHAPTER XXVII.

GENERAL AND SPECIAL LIABILITIES.*

§ 270. Endorsements.

A party placing his signature on a negotiable instrument for the purpose of transferring the ownership of such instrument or for the purpose of guaranteeing its genuineness or payment, is termed an endorser and his signature an endorsement. Any person placing his signature upon a negotiable instrument except as maker, drawer or acceptor is deemed to be an endorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity. (§§ 36, 113.)

An endorsement is usually but not necessarily placed upon the back of the instrument. It must, however, either be written on the instrument itself or on a paper attached thereto (§ 61) which is then termed an "allonge." An endorsement of a negotiable instrument must be for the entire amount due or to become due, and any endorsement transferring part of the amount does not transfer the title to the instrument. (§ 62.)

An endorsement may be special or blank (§ 63), in the first case specifying the person to whom, or to the order of whom, the instrument is to be paid; in the second case consisting merely of the name of the endorsing party. An instrument endorsed in blank is payable to bearer and is negotiated by delivery. (§ 64.) If an endorsement payable to bearer or endorsed in blank is by some later holder endorsed specially,

* Sectional references in text are to the Negotiable Instruments Law as enacted in the State of New York.

it may still be transferred by delivery under the original blank endorsement, and the person endorsing specially is liable as endorser only to the person or persons holding directly under his endorsement. (§ 70.) The holder may change a blank endorsement to a special endorsement by writing over the signature any endorsement he wishes, provided he does not change the undertakings of the instrument or the rights and responsibilities of the endorser by so doing. (§ 65.)

An endorsement which prohibits further negotiation as "Pay to John Wilson only" or which constitutes the endorsee an agent of the endorser, as "For Collection," or vests the title in a trustee, as "Pay James Brown for account of Helen Wilson," is termed a restrictive endorsement, but the absence of words implying power to negotiate does not make an endorsement restrictive. (§ 66.) For instance, an endorsement "Pay to John Harrison" does not restrict the further transfer of the instrument by endorsement and delivery.[1] A restrictive endorsement confers upon the endorsee the right to receive payment of the instrument, to bring any action thereon that the endorser could bring and to transfer these rights where the form of endorsement permits him so to do, but all subsequent endorsees acquire only the title of the restricted endorsee. (§ 67.)

An endorsement may also be qualified, as by adding "without recourse," or other words of similar import, to the endorsee's signature and such endorsement does not impair the negotiability of the instrument (§ 68), merely limiting the particular endorsee's liability.

An instrument drawn or endorsed to a person as treasurer or as some other fiscal officer of a corporation, is deemed *prima facie* to be payable to his corporation and may be transferred either by the endorsement of the officer or of his corporation.[2] (§ 72.) An endorsement in a representative capacity does not

[1] Leavitt v. Putnam, 3 N. Y. 494 (1850).

[2] First Nat. Bk. v. Hall, 44 N. Y. 395 (1871); Farmers', etc. Bank v. Troy City Bank, 1 Mich. 457 (1844).

involve personal liability if made in proper form.[3] (§ 74.)

If the name of an endorsee is wrongly designated or misspelled, he may endorse the instrument correspondingly, adding, if he sees fit, his own proper signature. (§ 73.) If an instrument is payable to two or more payees, not partners, all must endorse unless one or more have authority to endorse for all. (§ 71.)

The time of an endorsement, unless it is otherwise dated, is deemed *prima facie* to be before the maturity of the instrument (§ 75) and the place, unless the contrary appears, is presumed to be that of the place where instrument is dated. (§ 76.)

The holder may at any time strike out any endorsement not necessary to his title and such endorser and all endorsers subsequent to him are relieved from liability on the instrument. (§ 78.)

If the holder of an instrument payable to himself or to his order transfers it but neglects to endorse the instrument, the transferee takes only such title as 'the transferrer had therein. Any defenses that might have been made against the instrument in the hands of the payee may also be made against the instrument in the hands of the transferee. This transferee, however, may require the transferrer to affix his endorsement but this is only effective from the time it is affixed and not, as to outside equities, on the date of delivery. (§ 79.) This distinction is important as such an instrument transferred before but not endorsed until after maturity would only vest in the holder the rights of a transferee after maturity.[4]

An instrument may be endorsed conditionally but a party required to pay the instrument may safely do so and will be discharged whether the condition has been fulfilled or not. (§ 69.) " But any person to whom an instrument so endorsed

[3] Contra, Schmittler v. Simon, 101 N. Y. 554 (1886).

[4] Simpson v. Hall, 47 Conn. 417 (1879); Goshen Nat. Bank v. Bingham, 118 N. Y. 349 (1890); Beard v. Dedolph, 29 Wis. 136 (1871).

is negotiated, will hold the same, or the proceeds thereof, subject to the rights of the party endorsing conditionally." (Id.)

§ 271. Defective Title.

The title of a person negotiating an instrument is defective when he obtained the instrument, or any signature thereto, by fraud, duress, force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith or fraudulently. (§ 94.)

§ 272. Forgeries.

As defined by the New York Penal Code (§ 520), a forgery consists in "either falsely making, counterfeiting, altering, erasing or mutilating a genuine negotiable instrument in whole or in part or the false making or counterfeiting of the signature of the party thereto with intent to defraud." The intent to defraud must be present[5] and there must be an utterance or delivery of the forged instrument.[6]

"Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative and no right to retain the instrument or to give a discharge therefor or to enforce payment against any party thereto can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority." (§ 42.) This is also true under the common law.

The only exception to the general rule that forged paper is void is, as set forth in the Negotiable Instruments Law, where the person sought to be charged is precluded from setting up the forgery as a defense. This would be the case if the party were in collusion with the forgers or had made such

[5] People v. D'Argencour, 32 Hun 178; Aff'd, 95 N. Y. 624 (1884); Phelp v. People, 72 N. Y. 371 (1878).

[6] Daniel Neg. Insts., § 1350.

statements or had acted in such a way as to have induced other parties to act to their detriment upon the belief that the forged signature was genuine.[7]

When a forged instrument is not detected until after it has passed into innocent hands or payment has been made thereon, the party receiving the instrument or paying it may recover from the party from whom the instrument was received.[8] This rule does not hold, however, where the drawee pays a bill on which the signature of the drawer is forged, as the drawee is supposed to know his correspondent's signature and if he pays money upon the false signature, he himself must bear the loss.[9]

§ 273. Material Alterations.

A material alteration of a negotiable instrument is any one which changes,—(1) the date of the instrument;[10] (2) the sum payable either for principal or interest;[11] (3) the time or place of payment;[12] (4) the number or the relations of the parties;[13] (5) the medium or currency in which payment is to be made;[14] or (6) which adds a place of payment when no place of payment is specified[15] or which makes any other change or addition altering the effect of the instrument in any respect.[16] (§ 206.)

[7] Wellington v. Jackson, 121 Mass. 157 (1876); Workman v. Wright, 33 O. St. 405 (1878); contra, Shisler v. Vandike, 92 Pa. St. 449.

[8] Frank v. Lanier, 91 N. Y. 112 (1883); U. S. v. Nat. Park Bk., 6 Fed. Rep. 852 (1881).

[9] Goddard v. Merchants' Bk., 4 N. Y. 147 (1850); White v. Con. Nat. Bank, 64 N. Y. 316 (1876).

[10] Nat. Ulster Co. Bk. v. Madden, 114 N. Y. 280 (1889); Newman v. King, 54 O. St. 273 (1896).

[11] Hewins v. Cargill, 67 Maine 554 (1877); Gettysburg Nat. Bk. v. Chisolm, 169 Pa. St. 564 (1895).

[12] Miller v. Gilleand, 19 Pa. St. 119 (1852).

[13] Hoffman v. Planters' Nat. Bk., 39 S. E. Rep. 134 (1901).

[14] Anglo v. Ins. Co., 92 U. S. 330 (1875).

[15] Whitesides v. Northern Bk., 10 Bush 501 (1874).

[16] Weyerhauser v. Dun, 100 N. Y. 150 (1885).

If a negotiable instrument is materially altered without the assent of all parties liable thereon, it is voided except as against a party who has himself made, authorized or assented to the alteration and as to subsequent endorsers. (§ 205.) This same instrument, however, subsequently passing into the hands of a holder in due course who is not a party to the alteration, may be enforced by him according to the original tenor of the instrument. (Id.)

Under the common law, intent to defraud was an essential element in determining the effect of a material alteration. Under that law, if the alteration were fraudulent no recovery could be had upon the instrument or upon the consideration by any party possessing or taking the instrument with knowledge of the circumstances.[17] If, however, the alteration of the instrument was made without intent to defraud, recovery could be had in accordance with the original tenor of the instrument.

§ 274. Holder in Due Course.

Holders of negotiable instruments may be divided into two general classes,—holders in due course and holders not in due course.

A holder who has in good faith and for value taken a negotiable instrument, complete and regular upon its face and not overdue, and with no notice of any infirmity of the instrument or previous dishonor, or defect in the title of the transferrer, is termed a holder in due course (§ 91) and holds the instrument free from defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment thereof for its full amount against all parties liable thereon. (§ 96.)

These provisions are sweeping in their nature, validating instruments which are absolutely void in the hands of the original holder, and which, save in those states in which the

[17] Booth v. Powers, 56 N. Y. 22 (1874); Hunt v. Gray, 35 N. J. L. 227 (1871); Bigelow v. Stilphen, 35 Vt. 525 (1863).

Negotiable Instruments Law has been adopted, are as a rule void in the hands of an innocent holder for value as well, such as an usurious note, or one obtained by fraud or given in payment of a gambling debt.

Every holder of a negotiable instrument is deemed to be a holder in due course and the mere possession of the instrument is sufficient evidence of his title thereto until it is shown either that his or a prior title is defective. When, however, this is done, the burden of proof rests on the holder to show that he holds in due course. He must then explain his possession of the instrument and prove his own good faith in the matter,[18] but not as to the parties liable on the instrument before the time of the improper negotiation. (§ 96.) Thus the maker of a note could not interpose as a defense against the suit of a holder the fact that the note had been stolen from the payee or some endorser, nor throw on to the holder the burden of proof as to his own *bona fide* holding.

§ 275. Holder Not in Due Course.

The holder of an instrument is not a holder in due course if he takes an irregular or defective instrument, or takes it without consideration or for insufficient consideration, or takes it after its maturity, or takes it after dishonor with knowledge thereof, or takes it with knowledge of an infirmity in the instrument, or of a defect in the title of the transferrer, or takes an instrument payable on demand after an unreasonable time from its date of issue, or who holds his instrument fraudulently, or who holds it by simple assignment.

§ 276. What Constitutes Notice of Defect.

"To constitute notice of an infirmity in a negotiable instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had

[18] Canajoharie Nat. Bk. v. Diefendorf, 123 N. Y. 191 (1890); Conant v. Johnston, 165 Mass. 450 (1896).

actual knowledge of the infirmity or defect or such knowledge of the facts that his action in taking the instrument amounted to bad faith." (§ 95.) In other words, the transferee must have taken the instrument in good faith and if he has done this his title cannot be defeated by a previous defect in the title, even though he may have been negligent and have omitted the precautions in regard to the instrument which a prudent man would usually take.[19]

In the hands of a holder not in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. (§ 97.)

§ 277. Liability of Maker.

The maker of a negotiable instrument is liable for the payment thereof strictly according to its tenor when such instrument is in the hands of a holder in due course.

If, however, the instrument is in the hands of the original payee, he may bring up any existing defenses against its payment save that he is estopped from denying either the existence of the payee or his capacity to endorse at the time the instrument was issued. (§ 110.)

§ 278. Liability of Drawer.

The drawer of a negotiable instrument undertakes that on due presentment the instrument will be accepted and paid, according to its tenor, and if not, provided proper proceedings are taken on the dishonor of the instrument, that he will pay the amount thereof to the holder or to any subsequent endorser who may have been compelled to pay the instrument. Also the drawer is estopped from denying the existence of the payee and his capacity to endorse at the time the instrument was issued. The drawer may limit his liability by express stipulation in the instrument itself. (§ 111.)

[19] Cheever v. Pittsburgh, etc. R. R. Co., 150 N. Y. 59 (1896); Am., etc. Bank v. New York, etc. Co., 148 N. Y. 698 (1896).

§ 279. Liability of Acceptor.

The acceptor by accepting a negotiable instrument engages that he will pay it according to the tenor of his acceptance. He is also estopped by such acceptance from denying the existence of the drawer, the genuineness of his signature, his capacity and his authority to draw the instrument.[20] He is also held to admit the existence of the payee and his capacity to endorse at the time the instrument was accepted. (§ 112.)

§ 280. Liability of Transferrer by Delivery or Qualified Endorsement.

When an instrument is negotiated by delivery or by a qualified endorsement, i. e., " without recourse," unless otherwise expressly stated, the transferrer is held to warrant,—

"(1) That the instrument is genuine and in all respects what it purports to be.[21]

"(2) That he has a good title to it.[22]

"(3) That all prior parties have the capacity to contract.[23]

"(4) That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless."[24] (§ 115.)

But when the transfer is by delivery only, the transferrer's implied warranty extends no further than to his immediate transferee, and the warranty that all prior parties had power to contract does not apply to persons negotiating public or corporate securities, other than bills and notes.[25] (§ 115.)

The general refusal of a transferrer to guarantee the in-

[20] Nat. Park Bank v. Ninth Nat. Bank, 46 N. Y. 77 (1871).

[21] Littauer v. Goldman, 72 N. Y. 506 (1878); Wood v. Sheldon, 42 N. J. L. 425 (1880).

[22] Meriden Nat. Bk. v. Gallaudet, 120 N. Y. 298 (1890).

[23] Dalrymple v. Hillenbrand, 62 N. Y. 5 (1875); Glidden v. Chamberlain, 167 Mass. 486 (1897).

[24] Daskam v. Ullman, 74 Wis. 474 (1889).

[25] Otis v. Cullum, 92 U. S. 447 (1875).

strument will not relieve him from the usual implied warranties, but an express refusal at the time of transfer to warrant the genuineness of the instrument will be effectual.[26]

§ 281. Liability of Endorser.

When an instrument is transferred by endorsement without qualification, each endorser warrants to all subsequent holders in due course,—

(1) That the instrument is genuine; that he has a good title to it; that all prior parties have capacity to contract, and that the instrument is genuine in all respects and what it purports to be.

(2) That the instrument at the time of his endorsement is valid and subsisting.

(3) That on due presentment the instrument will be accepted or paid as the case may be, according to its tenor and that if it is not and the necessary proceedings on dishonor are duly observed, he will pay the amount thereof to the holder or to any subsequent endorser who may have been compelled to pay the instrument. (§ 116.) Where a holder places his endorsement on an instrument transferable by delivery, he incurs all the liabilities of a transferring endorser. (§ 117.)

§ 282. Liability of an Irregular Endorser.

When a party not otherwise a party to an instrument places thereon his signature in blank before the instrument is delivered, he is liable as an endorser, as follows:

"(1) If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties.

"(2) If the instrument is payable to the order of the maker or drawer or is payable to bearer, he is liable to all parties subsequent to the maker or drawer.

[26] Bell v. Dagg, 60 N. Y. 528 (1875).

"(3) If he signs for the accommodation of the payee, he is liable to all parties subsequent to the payee." (§ 114.)

The warranty of an irregular endorser is, as to the parties to whom he is liable, the same as that of any regular endorser.

§ 283. Order in which Endorsers are Liable.

In case of non-payment of a negotiable instrument, the holder may proceed against any or all of the endorsers. (§ 144.) As to one another the endorsers are severally and successively liable to all who succeed them, unless otherwise agreed.[27] (§ 118.)

§ 284. Liability of Agent and Broker.

An agent or a broker negotiating an instrument without endorsement is held to all the usual warranties,[28] unless he discloses the name of his principal and the fact that he is acting only as an agent. (§ 119.)

§ 285. Joint and Several Liability.

Parties who sign or endorse an instrument jointly must be joined in any proceeding for the collection of its amount and each one is liable only for his proportion of any amount recovered. If the parties sign severally, each is liable for the full amount of the instrument and suit for its payment may be brought against any one of them.

Where parties sign jointly and severally, suit may be brought against one or all at the option of the holder of the instrument. Where two or more persons sign an instrument containing the words "I promise to pay," they are deemed to be jointly and severally liable thereon. (§ 36.) Joint endorsers or joint payees who endorse, are deemed to endorse jointly and severally. (§ 118.)

[27] Easterly v. Barber, 66 N. Y. 433 (1876); Kelly v. Burroughs, 102 N. Y. 93 (1886); McCarty v. Roots, 62 U. S. 432 (1858).

[28] See § 280.

CHAPTER XXVIII.

COLLECTION.*

(1) PRESENTMENT.

§ 286. Necessity and Effect of Presentment.

The primary object of the presentment of a negotiable instrument for payment is to secure immediate payment of the amount due. Presentment is also usually essential to charge the parties secondarily liable, i. e., hold them to their liability for payment of the instrument in case the maker or acceptor, as the case may be, does not pay.

The person primarily liable, i. e., the maker or acceptor, is not relieved from his obligation if a negotiable instrument is not presented for payment at maturity. He may have been able and willing to pay it at its maturity at the place named in the instrument but this, though equivalent to a tender of payment on his part, does not release him in case the instrument is not presented, except that if suit be brought later on the non-presented instrument, he will not be liable for the damages and costs of the action.[1]

As to the drawer of the instrument and its endorsers, however, failure to present it for payment is ordinarily fatal, leaving them absolutely free from any further obligation on the instrument.[2] (§ 130.)

* Sectional references in text are to the Negotiable Instruments Law as enacted in the State of New York.

[1] Hills v. Place, 48 N. Y. 520 (1872); Parker v. Stroud, 98 N. Y. 379 (1885); Kox v. Nat. Bk., 100 U. S. 713 (1879).

[2] But see Com'l Bank of Albany v. Hughes, 17 Wend. 94 (1837); also as to checks, see Chap. XXII, § 224 of present volume.

§ 287. When Presentment is Not Necessary.

There are some exceptions to the rule requiring presentment. If the conditions are such that the drawer has no right to expect or require that the drawee or acceptor will pay the instrument, as where he draws a draft upon some one with whom he has no funds and without expectation of its payment, he is held without presentment. (§ 139.)

Also presentment is not requisite to charge an endorser when the instrument was made or accepted for his accommodation and he has no reason to expect that the instrument will be paid if presented. (§ 140.)

Also presentment may be dispensed with where with the exercise of reasonable diligence it is found impossible, or where the drawee is a fictitious person, or when the parties to the instrument have waived presentment either expressly or by implication. (§ 142.)

Waiver of presentment may be made either before or after maturity of the instrument, and may be either verbal or in writing.[3] Any usage, understanding, act or language calculated to induce the holder to refrain from demand or protest, is also sufficient.[4]

§ 288. General Requirements of Presentment.

"Presentment for payment to be sufficient must be made: (1) By the holder or by some person authorized to receive payment on his behalf; (2) at a reasonable hour on a business day; (3) at a proper place as herein defined; (4) to the person primarily liable on the instrument, or if he is absent or inaccessible, to any person found at the place where presentment is made." (§ 132.) The instrument must be exhibited to the person from whom payment is demanded and when it is paid must be delivered up to the party paying it. (§ 134.)

[3] Smith v. Lownsdale, 6 Ore. 79 (1876).

[4] Cady v. Bradshaw, 116 N. Y. 188 (1889); Ross v. Hurd, 71 N. Y. 14 (1877); Moyer & Bros.' Appeal, 87 Pa. 129 (1878).

§ 289. Who May Make Presentment.

Presentment must be made by the holder or some one authorized to receive payment on his behalf. (§ 132.) If the instrument is payable to the order of the payee and is endorsed by him in blank or is payable to bearer, its mere possession, in the absence of suspicious circumstances, is sufficient evidence of the holder's right to present it and to demand payment thereof[5] and unless such party is known to have acquired possession wrongfully, payment to him will always be valid.[6] If, however, the instrument is payable to order and is not endorsed by the payee, its possession alone is not sufficient evidence of the authority of an alleged agent by whom it is presented for payment.[7]

§ 290. Time of Presentment.

If the instrument is payable on demand, presentment must be made within a reasonable time after its issue, " except that in case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof." If the instrument is not payable on demand, presentment must be made on the day it falls due. (§ 131.)

The " reasonable time " within which an instrument payable on demand must be presented will be governed by conditions and is a subject of many diverse decisions, the periods held reasonable ranging from a day or a few days in the case of checks up to months in case of notes and drafts. As stated in the Negotiable Instruments Law (§ 4), in determining what is a reasonable time, " regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments and the facts of the particular case.".

Delay in presentment is, however, excusable when it " is

[5] Sussex Bk. v. Baldwin, 17 N. J. L. 487 (1840).

[6] Daniel Neg. Insts., § 574.

[7] Doubleday v. Kress, 50 N. Y. 410 (1872).

caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made with reasonable diligence." (§ 141.) Miscarriage in the mail is, for instance, deemed a sufficient excuse for delay[8] and sickness may be.[9]

If the instrument is payable at a bank it must be presented for payment within banking hours, or if the party primarily liable has no funds there for the payment of the instrument, any hour before the bank is closed on the day of maturity is sufficient. (§ 135.) If not payable at a bank the holder may present it at any reasonable hour during the day. If presentment is made at his place of business it must be during the usual business hours, or, if otherwise, while some one is there competent to attend to the matter.[10]

§ 291. Place of Presentment.

Presentment " for payment is made at the proper place, (1) where the place of payment is specified in the instrument and it is there presented; (2) where no place of payment is specified but the address of the person to make payment is given in the instrument and it is there presented; (3) where no place of payment is specified and no address is given and the instrument is presented at the usual place of business or residence of the person to make payment; (4) in any other case if presented to the person to make payment wherever he can be found, or if presented at his last known place of business or residence." (§ 133.)

Presentment during business hours at the place of business of the person to make payment is sufficient to hold endorsers whether such person is there or no and even though the place

[8] Windham Bk. v. Norton, 22 Conn. 213 (1852).

[9] Wilson v. Senier, 14 Wis. 411 (1861).

[10] Waring v. Betts, 90 Va. 46 (1893).

be closed, if no explanation of such closing is apparent[11] and the party has no other place of business or residence in the city which could be ascertained by reasonable enquiry.

In cases "where the instrument is made payable at a bank, it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon." (§ 147.) This practically makes a negotiable instrument payable at a certain bank, a draft on that bank and the bank may pay such instrument when due and charge it to the account of the maker or acceptor of the instrument as the case may be, without further authorization.[12]

§ 292. To Whom Presented.

"The instrument must be exhibited to the person from whom payment is demanded and when it is paid must be delivered up to the party paying." (§ 134.)

"Where the person primarily liable on the instrument is dead, and no place of payment is specified, presentment for payment must be made to his personal representative, if such there be, and if, with the exercise of reasonable diligence, he can be found." (§ 136.) "Where the persons primarily liable on the instrument are liable as partners and no place of payment is specified, presentment for payment may be made to anyone of them, even though there has been a dissolution of the firm." (§ 137.) "Where there are several persons not partners primarily liable on the instrument and no place of payment is specified, presentment must be made to them all." (§ 138.)

In case any party to whom presentment should be made cannot be found by the exercise of reasonable diligence, presentment as to him may be dispensed with. (§ 142.)

[11] Wallace v. Crille, 46 Wis. 577 (1879); Shedd v. Brett, 18 Mass. 401 (1823); Sulzbacner v. Bank of Charleston, 86 Tenn. 201 (1887).

[12] Aetna Nat. Bk. v. Fourth Nat. Bk., 46 N. Y. 82 (1871).

(2) DISHONOR.

§ 293. When an Instrument is Dishonored.

A negotiable instrument is said to be dishonored when it is duly presented for payment and payment is refused or cannot be obtained, or when presentment is excused or is unnecessary or impossible and the instrument is overdue and unpaid. (§ 143.) Also an instrument that must be accepted is dishonored by a non-acceptance when it is duly presented for acceptance. (§§ 221, 247.)

§ 294. Rights of Holder on Dishonor.

When an instrument is dishonored by non-payment or non-acceptance after proper demand therefor, the holder has immediate right of recourse on all the parties secondarily liable thereon (§ 144), provided due notice of such dishonor has been given these secondary parties. By such notice the endorser's liability is changed from that of a mere surety to that of an independent and principal debtor,[13] but if due notice of dishonor is not given to the parties secondarily liable, their liability on the instrument is discharged and cannot thereafter be revived.

§ 295. Protest.

Protest, in the ordinary use of the term, includes all the steps necessary to charge the parties secondarily liable on a negotiable instrument. In the more technical use of the term it is restricted to the formal presentment of a negotiable instrument with demand for payment or acceptance, as the case may be, made by a notary public or other qualified person after the dishonor of the instrument, such presentment and demand being formally certified to by the person making the protest presentment.

[13] German-Am. Bk. v. Niagara Cycle Co., 13 App. Div. (N. Y.) 450 (1897).

Protest may be made when any negotiable instrument has been dishonored but is not essential to hold the parties secondarily liable save only in the case of foreign bills of exchange. (§§ 189, 260.) A foreign bill of exchange, however, appearing on its face to be such, must be protested on non-acceptance, or, after acceptance, on dishonor by non-payment, as otherwise the drawer and endorsers are discharged. (§ 260.)

In practice protest is almost always employed in case of the dishonor of any negotiable instrument because of its convenience in proving the fact and circumstances of dishonor and of notice to the endorsers. In almost every state of the Union the certificate of the notary making a protest is *prima facie* evidence of the facts.

Any party to an instrument may waive protest and in such case is also held to waive presentment and notice of dishonor. (§ 182.)

Protest may be made by a notary public. It may also be made by any respectable resident of the place where the bill is dishonored if made in the presence of two or more credible witnesses. (§ 262.) The demand must be made by the notary public or such other party in person.[14] "The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify,—(1) the time and place of presentment; (2) the fact that presentment was made and the manner thereof; (3) the cause or reason for protesting the bill; (4) the demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found." (§ 261.)

The protest must be made or begun on the date of dishonor (§ 263) at the place where the instrument is dishonored, unless the instrument is drawn payable at some other place, when it must be protested at the place where it is expressed to be payable. (§ 264.)

[14] Com'l Bk. v. Varnum, 49 N. Y. 269 (1872); Ocean Nat. Bk. v. Williams, 102 Mass. 141 (1869).

A bill which has been protested for non-acceptance may be subsequently protested for non-payment. (§ 265.) An accepted bill may be protested before maturity if the acceptor becomes insolvent or has made an assignment for the benefit of creditors. (§ 266.) Protest may be dispensed with by any circumstances which would dispense with notice of dishonor, and delay in protesting is excused under the same circumstances as delay in presentment. (§ 267.)

If a bill is lost or destroyed or is wrongfully detained from the person who is entitled to hold it, protest may be made on a copy or on written particulars thereof. (§ 268.) The loss does not excuse demand and protest.

§ 296. To Whom Notice of Dishonor is Given.

"Notice of dishonor must be given to the drawer and to each endorser" of a negotiable instrument, "and any drawer and endorser to whom such notice is not given is discharged." (§ 160.) The notice of dishonor may be given either to the party himself or to his agent who has authority to act in the matter. (§ 168.) The burden of proving that due notice has been given is on the holder.[15]

If any party is dead, the notice must be given to a personal representative of the deceased, or if such representative cannot with reasonable diligence be found, notice may be sent to the last residence or place of business of the deceased party. (§ 169.) If the parties to be notified are partners, notice to any one partner is notice to the firm even though there has been a dissolution (§ 170), but if one of the partners is the maker and the other the endorser of a promissory note, the latter is not liable on his endorsement unless duly notified of the dishonor of the note.[16]

"Notice to joint parties who are not partners must be given to each of them unless one of them has authority to

[15] Marks v. Boone, 24 Fla. 177 (1888).

[16] Foland v. Boyd, 23 Pa. St. 476 (1854).

receive such notice for the others." (§ 171.) "Where a party has been adjudged a bankrupt or is insolvent or has made an assignment for the benefit of creditors, notice may be given either to the party himself or to his trustee or assignee." (§ 172.)

§ 297. By Whom Notice of Dishonor May be Given.

Notice of dishonor may be given by the holder or by any person on behalf of the holder, or by or on behalf of any party to the instrument who might be compelled to pay it to the holder, and who upon paying it would have a right to reimbursement from the party or parties to whom notice is given (§ 161), but notice by a stranger is not sufficient.[17]

"Where the instrument has been dishonored in the hands of an agent, he may either himself give notice to the party liable thereon or he may give notice to his principal."[18] (§ 165.)

"Notice of dishonor may be given by an agent either in his own name or in the name of any party entitled to give notice, whether that party be his principal or not." (§ 162.)

§ 298. Effect of Notice of Dishonor.

Where any party secondarily liable is charged by notice of dishonor, it inures to the benefit of all parties who have right of recourse against the party notified. (§§ 163, 164.) Thus if a holder merely gives notice to his immediate endorser, this endorser and he alone is held. If, however, this endorser duly notifies the other parties secondarily liable they also are held and are then liable not only to the endorser but to the holder as well.[19]

"An omission to give notice of dishonor by non-accept-

[17] Chanoine v. Fowler, 3 Wend. 173 (1829).

[18] See § 301.

[19] Mead v. Engs, 5 Cow. 303 (1826); Smith v. Poillon, 87 N. Y. 590 (1882).

ance does not prejudice the rights of a holder in due course subsequent to the omission." (§ 188.)

§ 299. Form of Notice of Dishonor.

Notice of dishonor may be in writing or merely oral and may be given in any terms which sufficiently identify the instrument and indicate that it has been dishonored by non-acceptance or non-payment, as the case may be. The written notice need not be signed and a written notice otherwise insufficient may be supplemented verbally and thereby validated. An erroneous description of the instrument does not vitiate the notice unless the party to whom the notice is given is in fact mislead thereby. (§§ 166, 167.)

The notice should be sufficiently clear to identify the instrument and should state with equal distinctness that the instrument has been dishonored. An instrument is sufficiently described if its maker, acceptor, if such there be, payee, date, amount and time of payment are stated.[20]

§ 300. How Notice of Dishonor is Given.

Notice may be given either by personal delivery or through the mails. (§ 167.) Under the common law it was well settled that if the parties to be notified resided in the same place as the party giving notice, their notice must be personal.[21] The Negotiable Instruments Law, however, makes a notice by mail sufficient under any circumstancs. Also " where notice of dishonor is duly addressed and deposited in the post-office, the sender is deemed to have given due notice, notwithstanding any miscarriage in the mails."[22] (§ 176.) "Notice is deemed to have been deposited in the post-office when de-

[20] Bank of Cooperstown v. Woods, 28 N. Y. 545 (1864).

[21] Sheldon v. Benham, 4 Hill. 129 (1843); Westfall v. Farwell, 13 Wis. 504 (1861).

[22] Windham v. Norton, 22 Conn. 213 (1852); Shedd v. Brett, 18 Mass. 401 (1823).

posited in any branch post-office or in any letter box under the control of the post-office department."[23] (§ 177.)

§ 301. Time of Notice of Dishonor.

Notice may be given as soon as an instrument is dishonored, regardless of the fact that business hours of the day of maturity have not closed. (§ 173.)

If the person giving and the person receiving notice reside in the same place, notice, if at the latter's place of business, must be given before the close of business hours on the day following. If sent by mail, the notice must be deposited in the post-office in time to reach the party to be notified in usual course on the day following. (§ 174.) If service of notice is properly made, its failure to reach the party to be notified does not vitiate its effect.[24]

"Where the parties giving and to receive notice reside in different places, the notice must, if sent by mail, be deposited in the post-office in time to be forwarded the day following the day of dishonor or if there be no mail at a convenient hour on that day, by the next mail thereafter." If given otherwise than through the post-office it must be served so that notice will be received within the same time as if the notice had been mailed in accordance with the preceding provisions. (§ 175.) If the notice when mailed is not received in due time, the burden of proof is upon the plaintiff to show that it was mailed at the proper time.[25]

"Where a party receives notice of dishonor he has, after receipt of such notice, the same time for giving notice to antecedent parties that the holder has after dishonor." (§ 178.) A delay in giving notice of dishonor, if it occurs through circumstances beyond the control of the holder and not due to his default, misconduct or negligence, is excused, provided notice

[23] Johnson v. Brown, 154 Mass. 105 (1891).

[24] Adams v. Wight, 14 Wis. 442 (1861).

[25] Friend v. Wilkinson, 50 Va. 31 (1852).

is given with reasonable diligence as soon as the cause of delay ceases to operate. (§ 184.)

If an instrument is dishonored in the hands of an agent, he must, if he gives notice to his principal, do so within the same time as allowed the holder for notice, and the principal on receipt of such notice has a similar time in which to notify the parties to be held. (§ 165.)

§ 302. Where Notice of Dishonor Must be Given.

If a party to a negotiable instrument adds an address to his signature, notice of dishonor must be sent to that address. Otherwise it may be sent to the post-office nearest to his place of residence or to the post-office where he is accustomed to receive his letters, or, if he lives in one place and has his place of business in another, notice may be sent to either place, or if he is journeying to another place, notice may be sent to such place. Where notice is actually received by the party within the time provided, it will be sufficient no matter by what means it is served. (§ 179.)

§ 303. Waiver of Notice of Dishonor.

Notice of dishonor may be waived either expressly or by implication and either verbally or in writing and either before the dishonor of the instrument or thereafter. (§ 180.) The waiver must, however, be unmistakable and with a knowledge of the facts.[26]

"Where the waiver is embodied in the instrument itself it is binding upon all parties, but where it is written above the signature of an endorser, it binds him only." (§ 181.)

A waiver of protest in the case of any negotiable instrument is also deemed to be a waiver of presentment and notice of dishonor. (§ 182.)

[26] Jenkins v. White, 147 Pa. St. 303 (1892); Lockwood v. Crawford, 18 Conn. 360 (1847).

§ 304. When Notice of Dishonor is Unnecessary.

"Notice of dishonor is dispensed with, after the exercise of reasonable diligence, it cannot be given to or does not reach the parties sought to be charged." (§ 183.)

Notice of dishonor is not required to be given to the drawer of a negotiable instrument if he is also the drawee, or if the drawee is a fictitious person or a person unable to contract, or where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument, or where he himself is the person to whom the instrument is presented for payment, or in case he has countermanded payment. (§ 185.)

An endorser need not be notified of dishonor when the drawee is a fictitious person or unable to contract and the endorser was aware of the fact at the time he endorsed, or where the endorser is a person to whom the instrument is presented for payment, or where the instrument was made or accepted for his accommodation. (§ 186.)

Also "where due notice of dishonor by non-acceptance has been given, notice of subsequent dishonor by non-payment is not necessary unless in the meantime the instrument has been accepted." (§ 187.)

(3) PAYMENT AND DISCHARGE.

§ 305. Payment in Due Course.

Payment made in good faith by the party primarily liable on or after maturity of the instrument to the holder thereof, made without notice or knowledge of any defect in the title of such holder, is payment in due course and discharges the instrument and all the parties liable thereon. (§ 148.)

The instrument when paid must be delivered up to the party by whom it is paid. (§ 134.) Any collateral securing a note must be delivered up with the note when payment is made. It is the duty of the party paying the instrument to take it up when paid, and if he does not but accepts a receipt in lieu thereof and the instrument turns up later in the hands of a holder in due course, the first payment is ineffectual and he must pay it again.[27]

§ 306. Discharge of Instrument.

A negotiable instrument is discharged by payment in due course by or on behalf of the principal debtor, or in the case of accommodation paper, on payment by the party accommodated. It is likewise discharged by the intentional cancellation thereof by the holder, and also when the principal debtor becomes a holder of the instrument in his own right at maturity or thereafter, or by any other act which will discharge a simple contract for the payment of money. (§ 200.)

Payment by an endorser does not discharge the maker but the release of one joint maker will operate to discharge the other joint maker provided the release be under seal; if unsealed it has not that effect.[28]

§ 307. Discharge of Persons Primarily Liable.

The maker or acceptor of a negotiable instrument is discharged by the discharge of the instrument.

§ 308. Discharge of Persons Secondarily Liable.

A person secondarily liable upon a negotiable instrument is discharged, (1) by the discharge of the instrument; (2) by the intentional cancellation of his signature by the holder; (3) by the discharge of a prior party; (4) by a valid tender of payment made by a prior party; (5) by a release of the maker or acceptor, unless the holder's right of recourse against the parties secondarily liable is expressly reserved; (6) by any agreement, binding upon the holder, to extend the time of

[27] Adams v. Lenox, 15 Ore. 489 (1887); Wheeler v. Guild, 37 Mass. 545 (1838).

[28] Crawford v. Roberts, 8 Ore. 324 (1880); Shaw v. Pratt, 39 Mass. 305 (1839).

payment or to postpone the holder's right to enforce the instrument, unless the right of recourse against such party is expressly reserved. (§ 201.)

The reservation of liability against the parties secondarily liable could, of course, only be made with their consent; also any extension of time for payment, no matter how short, will discharge the endorsers or sureties, unless made with the express agreement of these secondary parties.

§ 309. Payment by Party Secondarily Liable.

Where an instrument is paid by a party secondarily liable thereon, it is not discharged, but the party so paying it occupies the same position that he did before endorsing the instrument as regards all prior parties and he may, if he wishes, strike out his own and all subsequent endorsements and again negotiate the instrument except (1) where it is payable to the order of a third person and has been paid by the drawer, or (2) where it was accommodation paper and has been paid by the party accommodated.

§ 310. Renunciation and Cancellation.

The holder may by written renunciation or by delivering the instrument to the person primarily liable thereon, renounce his rights against any party to the instrument at any time. An absolute and unconditional renunciation of his rights against the principal debtor made on or after the maturity of the instrument discharges it absolutely, but renunciation made before maturity does not affect the rights of a holder in due course without notice. (§ 203.)

CHAPTER XXIX.

BILLS AND NOTES.*

§ 311. General.

In the preceding chapters the subject of negotiable instruments is treated at some length. Bills of exchange—or drafts as they are more commonly termed—and notes come under the general rules laid down in those chapters. The present chapter therefore confines itself to features which are peculiar to bills and notes, or which are of special importance.

§ 312. Payment by Drafts and Notes.

When payment is made by a note, the debt for which it is given is extinguished as completely as if payment were made in cash. Payment by draft is equally effectual as soon as the draft has been accepted by the party upon whom it is drawn. If either note or draft is not paid when due, suit for payment may be brought against the parties liable thereon but the original claim is not revived. The obligation of the note or draft has been substituted for that of the original account.

As long as a note or draft remains in the hands of the party in whose favor it is drawn, the fact that it is a negotiable instrument is of no particular advantage. The instrument when due is subject to all of the ordinary defenses for debt, and any amounts owing from the payee to the party who gave the note or draft may be set off against it, or if the consideration for which the instrument was given has failed, payment might be refused entirely.[1]

* Sectional references in text are to the Negotiable Instruments Law as enacted in New York.

[1] See § 261.

As soon, however, as a note or draft passes into the hands of a third party, it comes with a clean bill of health, i. e., its full amount must be paid in accordance with its terms and usually entirely regardless of the conditions under which it was given.

Notes and drafts may therefore be taken by endorsement without concern as to the relations existing between the original parties. It is also to be noted that when a note or draft is taken by endorsement in settlement of a debt, the status of the debt is materially strengthened. The original debtor is still held as an endorser of the note or draft. In addition to this the holder has the prior obligation of the maker of the note or the acceptor of the draft and also of any endorsees and, in the case of a draft, of the drawer as well. If the party primarily liable on the instrument does not pay, the holder may proceed against these others until payment is secured.

A note or draft may not, however, be taken by endorsement with safety unless the instrument itself is correct in form[2] and is taken in good faith and for valuable consideration.[3] Also as a matter of ordinary business precaution, the parties to the instrument should be responsible. In addition to this, if the instrument is not accepted or paid when properly presented to the parties primarily responsible, the requirements of the law as to protest and notice must be strictly complied with if the parties secondarily responsible are to be held.[4]

§ 313. Bills of Exchange.

A bill of exchange—commonly known as a draft—is a written order, unconditional in its terms, signed by the giver and addressed to some specified party, directing him to pay a certain sum of money to the party named in the draft or to his order, or to the bearer. A draft payable in the state or the

[2] See § 262.

[3] See § 274.

[4] Ch. XXVIII, "Collection."

country in which it is drawn is termed an "inland" bill of exchange but if payable in another state or country, is known as a "foreign" bill of exchange.

The party by whom a draft is drawn is termed the "drawer." The party on whom it is drawn is the "drawee." The party to whom its amount is to be paid is termed the "payee." If the payee transfers the draft by endorsement, he becomes the "endorser" of the draft and the party to whom it is transferred is known as the "endorsee."

A draft implies that the drawer has funds in the drawee's hands or that money is due him from the drawee to the amount of the draft and that in either case the amount is subject to his order. If the draft is payable at some future time it is usually presented at once to the drawee for his acceptance. If the drawee intends to pay, he writes "Accepted" across the face of the draft and signs his name.

Up to this point the draft is much in the nature of a check. It is merely an order for money and the payee has no legal claim against the drawee, nor is the draft necessarily a payment of the debt against which it was given. As soon as accepted, however, the legal effect of the draft is changed. It then becomes an absolute obligation of the acceptor, and the debt against which it was given is extinguished. The drawer is responsible for the payment of the draft in case the acceptor fails to meet it when due, but he is no longer liable on the original claim.

§ 314. Promissory Notes.

A promissory note or a note of hand is the written promise of the party by whom it is made to pay to some person specified in the instrument or his order, or to bearer, a certain sum of money. The party by whom the note is made is known as the "maker." The party to whom it is payable is termed the "payee." If this payee transfers the note by endorsement, he is then known as the " endorser " and the party to whom it is transferred is known as the " endorsee."

§ 315. Similarity between Drafts and Notes.

A draft is an order for money. A note is a promise to pay money. When, however, a draft is accepted, it becomes the promise of the acceptor to pay its amount and then the draft and the note are practically the same thing.

The acceptor of the draft corresponds to the maker of the note, both promising to pay their respective obligations. The payee of the note and the payee of the draft likewise occupy corresponding positions. The drawer of the draft, however, has no counterpart in the note as long as it remains unendorsed. If, however, the payee of the note transfers it by endorsement to some one else, his position as endorser of the note is legally identical with that of the drawer of the draft and the resemblance between the two instruments is complete.

§ 316. Negotiability of Drafts and Notes.

As stated in a preceding chapter, certain features must appear in drafts and notes as a prerequisite of negotiability.[5] If any of these are omitted, the instrument may still be perfectly valid but it is not negotiable. It cannot be transferred by mere endorsement and delivery, or by delivery alone but only by assignment as in any other ordinary contract. Also when so transferred it is still subject to all the defenses existing between the original parties.

While this is true, any additional matter desired may be brought into a note or draft, and, provided this does not interfere with the requisites of negotiability, the instrument is still negotiable. For instance, a statement in a note that it is given in payment of a certain account, or that it is one of a

[5] See § 262.

series, or that it is given for value received, does not affect the negotiability of the instrument in any way.

§ 317. Extraneous Matter.

Any such memoranda or additional matter entered upon a draft or note are considered part of the instrument if so entered at the time the instrument is executed, or are effective if entered thereafter by consent of all the parties interested. They are, however, of no effect whatsoever if entered by a stranger without consent of the parties. If made by some holder of the instrument without consent of the other parties, such additions are either ineffective or, if material,[6] void the instrument.

§ 318. Presentment of Drafts for Acceptance.

A draft is an order for the payment of money but the drawee is not liable nor has the holder of the instrument any legal remedy against him until he has accepted the draft. Therefore, although in many cases the acceptance of a draft is not necessary to hold the drawer and any endorsers responsible, it is always a matter of prudence and good business to present the draft for acceptance as soon as possible. When accepted, not only is the drawer liable for the payment of the amount but the drawee is bound as well and the security of the debt is thereby materially improved.

In order to hold the drawers and endorsers, a draft must either be presented for acceptance or be negotiated—when the party receiving it must present it for acceptance or in his turn negotiate it—within a reasonable time in the following cases;—(a) where acceptance is necessary in order to fix the maturity of the instrument; (b) when the draft expressly stipulates that it shall be presented for acceptance; (c) when

[6] See § 273.

the draft is payable elsewhere than at the residence or place of business of the drawee. (§§ 240, 241.)

§ 319. When Presentment for Acceptance is Excused.

Presentment is excused and a draft treated as dishonored by non-acceptance under the following circumstances;—(a) where the drawee is dead or has absconded, or is a fictitious person or a person not having capacity to contract by bill; (b) where presentment cannot be made by the exercise of reasonable diligence; (c) where an irregular presentment has been made and acceptance has been refused on some other grounds. (§ 245.)

Also presentment is excused where a draft is payable elsewhere than at the place of business or the residence of the drawee and the holder has not time with the exercise of reasonable diligence to present the bill for acceptance before it falls due. In this case the bill is not considered dishonored by its non-acceptance but the drawer and endorsers are held in spite of the delay in presentment for acceptance. (§ 244.)

§ 320. Manner of Presentment for Acceptance.

Presentment for acceptance must be made by or on behalf of the holder at a reasonable hour on a business day before the draft is overdue, and must be made to the drawee or some person authorized to accept or refuse acceptance on his behalf.

If a draft is addressed to two or more drawees who are not partners, presentment must be made to all unless one has authority to act for all. If the drawee has been adjudged a bankrupt or is insolvent or has made an assignment for the benefit of creditors, presentment may be made to him or his trustees or assignee. Presentment may be made on any day on which a negotiable instrument may be presented for payment.[7] (§ 243.)

[7] See §§ 266, 288.

§ 321. Dishonor by Non-Acceptance.

If a draft is duly presented for acceptance and acceptance is refused or cannot be obtained, or if the conditions are such that presentment for acceptance is excused and the draft is not accepted, it is then said to be dishonored by non-acceptance. (§ 246.)

When a draft is dishonored by non-acceptance, immediate right of recourse against the drawer and endorsers accrues to the holder and no presentment for payment thereafter is necessary. (§ 248.) The holder must then proceed in accordance with the rules as to protest and notice laid down in Chap. XXVIII, §§ 293-304, or otherwise he loses his right of recourse against the parties to the instrument. (§ 247.)

§ 322. Acceptance of Drafts.

The holder of a draft is always entitled to its acceptance on due presentation therefor and may require the acceptance to be in writing on the draft and if his request is refused, may treat the draft as dishonored. (§ 221.)

An acceptance of a draft must always be in writing and be signed by the drawee and must not state that the drawee will perform his promise by any other means than the payment of money. (§ 220.)

An acceptance is valid if written on a separate paper but does not then bind the acceptor save as to persons to whom it is shown and who on faith therein receive the bill for value. (§ 222.) Also an unconditional promise in writing to accept a draft, though made before the draft is drawn, is deemed an actual acceptance in favor of every person who on faith therein receives such draft for value. (§ 223.)

Also if a drawee to whom a draft is delivered for acceptance, destroys the same or refuses within twenty-four hours after such delivery or within such other period as the holder may allow, to return the draft accepted or non-accepted to the holder, he will be deemed to have accepted the same. (§ 225.)

Also a draft may be accepted before it is signed by the drawer or while otherwise incomplete or when it is overdue, or—as of the date of the first presentment—after it has been dishonored by a previous refusal to accept, or by non-payment. (§ 226.)

§ 323. Time for Acceptance.

The drawee is allowed twenty-four hours after presentment in which to decide whether or not he will accept a draft, but the acceptance, if given, dates as of the date of presentment. (§ 224.)

§ 324. Kinds of Acceptances.

An acceptance is either general or qualified.

A general acceptance assents without qualification to the order of the drawer, save that it may provide for payment at a particular place if it does not expressly limit the payment to that place only. (§§ 227, 228.)

A qualified acceptance in express terms varies the effect of the draft as drawn. Such an acceptance may be,—(a) conditional, making payment by the acceptor dependent on the fulfilment of some condition therein stated; (b) partial, agreeing to pay a part only of the amount called for by the draft; (c) local, agreeing to pay only at a particular place; (d) qualified as to time; (e) partial as to drawees—that is acceptance by one or more of the drawees, but not by all. (§§ 227, 229.)

§ 325. Rights of a Holder as to Qualified Acceptance.

The holder of a draft may refuse to take a qualified acceptance if he so elects and, if he is refused an unqualified acceptance, may treat the draft as dishonored by non-acceptance. If he takes the qualified acceptance, the drawer and any endorsers on the draft are discharged from liability unless they have expressly or impliedly authorized the holder to take a qualified acceptance, or subsequently assent thereto. When the drawer or an endorser receives notice of a qualified acceptance, he will be deemed to have assented thereto unless he expresses his dissent to the holder within a reasonable time. (§ 230.)

§ 326. Bills in Sets.

Drafts are sometimes drawn in sets, each part or member being numbered and containing a reference to the other parts, and the entire set constituting but one instrument. (§ 310.)

When drafts are so drawn, it is understood that but one member of the set is to be negotiated, unless that part is lost or destroyed, when another may be substituted for the lost member. The drawee, therefore, may accept and pay any part of a bill in a set that is presented to him, but must accept the one part only, must pay this accepted part only and require its surrender to him when paid. Otherwise he may perhaps be required to pay a second time. (§§ 313, 314.)

If the holder of a bill in parts endorses two or more parts to different persons, each part becomes in effect a separate bill on which the holder is liable. As to the parties who receive such improperly negotiated bills, the holder whose title first accrues is, as between such holders, the true owner of the bill but this does not in any way affect the rights of the drawee. If without knowledge of the improper negotiation he accepts and pays the part first presented to him, he is discharged. (§§ 311, 312.)

Unless a bill drawn in a set is improperly negotiated or accepted, the payment of one part discharges the whole bill. (§ 315.)

PART V.—CORPORATE SECURITIES.

CHAPTER XXX.

CAPITAL STOCK.

§ 327. Capitalization.

In corporate matters the term "capitalization" ordinarily means the total authorized capital stock of a corporation. This covers both common and preferred stock, whether issued or unissued, but does not include bonds or any other corporate obligations.

In the economic discussions of finance and in financial adjustments and calculations, the term is frequently given a broader signification, including then not only the authorized capital stock of the corporation but also any bonds and other similar corporate obligations which may have been issued by the particular corporation.

§ 328. Capital Stock.

The capital stock of a corporation is its nominal or share capital as distinguished from its actual or property capital. The two are absolutely distinct. They may be and at times are the same in amount, but are never the same in nature.

The amount of a corporation's capital stock is fixed primarily by its incorporators and is included as one of the details in their application to the state for a charter. If this application is allowed by the state authorities, the capital stock tentatively determined by the incorporators is thereby confirmed and made positive. Those in control of the corporation are then authorized to issue stock for value up to any desired amount not exceeding that fixed by the charter. (See § 334.) Usually the statutes require that some minimum amount of capital stock must be issued or subscribed for (See § 185 (d)), but between this minimum and the maximum authorized by the charter, the directors have full discretion and may issue as much or as little as they see fit. They cannot, however, exceed the authorized amount unless they first secure the right by an amendment of their charter.

If no provision is made to the contrary, all the capital stock authorized by the charter is common stock. (See § 337.) If a portion of the stock is to be preferred stock, it must usually be so designated in the charter, the respective amounts of common and preferred stock then together making up the total of the authorized capital stock.

§ 329. Capital.

The capital of a corporation as in any other business concern, is the net value of its assets. It is manifest that this capital will vary directly with the vicissitudes of the corporate business. If the corporation is prosperous, its capital will increase; if otherwise, its capital will diminish.

The capital of a corporation is usually derived in the first place from the sale of its capital stock. In most states of the Union this capital stock may be issued for cash, property or labor, but the statutes usually provide that the values received must be at least equal to the nominal value of the issued stock.

Thus if a corporation with an authorized capital stock of $100,000 issues this entire stock for property, it is supposed that the property received is of the actual value of $100,000. If this is the case, the capital stock of the corporation and its capital are at this point exactly equal in amount. The capital stock, however, remains a fixed quantity thereafter, whereas the capital, as stated, may change with every variation of the corporate business. It is but rarely that the two remain the same in amount for any length of time.

In fixing the amount of capital stock, the incorporators are usually governed by the requirements of the particular corporation. The statutes of most of the states require a certain minimum capital stock and in a few states a maximum is fixed which cannot be exceeded, but within these limits the incorporators may exercise their discretion. In a conservative corporation there will usually be some approximation or relation between the capital stock and the amount of capital expected or arranged for, though even here the capital stock is frequently fixed at a figure materially exceeding the property assets of the corporation. This is done perhaps to cover the good-will or dividend-paying abilities of the business taken over, or to provide a reserve of stock to be sold later for additional capital, or to meet some other requirement of the particular business.

§ 330. Shares and Their Par Value.

The capital stock of a corporation is always divided into equal parts called shares. Usually this is a matter of statutory requirement but it is also a matter of custom and convenience. These shares have a nominal value, expressing their relation to the capital stock. Thus if the capital stock of a corporation is $5,000 and there are fifty shares, each share constitutes one-fiftieth of the entire capital stock and has a nominal value of $100. This nominal value of the share is called its face or par value as opposed to its real or market value. The real value expresses with more or less accuracy the relation—or supposed relation—of the share to the actual capital of the corporation. An inspection of the daily stock quotations will show how widely the par value and the real value of stock vary. It is but seldom that the two are the same.

Usually shares may be made of any face or par value desired, though in some states certain limits are fixed, as for instance in New York where the shares may not be less than $5 nor more than $100. The face value of these shares is determined by the incorporators at the time they fix the capital stock and is confirmed, as in the case of capital stock, by the granting of the charter application. The usual par value is $100, save in the more speculative corporations such as mining companies, where $1 is a favorite par value. Ten dollar shares are not uncommon, fifty dollar shares are issued by some very prominent corporations, as for instance the Pennsylvania Railroad, and occasionally shares of the par value of $500 are encountered. The one hundred dollar share is usually to be preferred on account of its general use and convenience.

As the shares of stock bear a direct relation to the total capital stock of a corporation, it follows that the number of these shares held by any individual represents his proportionate interest in the corporate undertaking.

Thus in a corporation with a capital stock of $5,000 divided into fifty shares, all of which is common stock, the man who holds five shares has a one-tenth interest in the corporate undertaking and participates on this basis in its management, its profits and in any division of assets. If an election is held, he is ordinarily entitled to cast one-tenth of the total number of votes. If dividends are declared, one-tenth of them belong to him. If the corporation is liquidated, he is entitled to one-tenth part of all assets distributed to the stockholders.

As shares of stock in the hands of a stockholder merely represent his interest in the corporate business, these shares are personal property even though the entire capital of the corporation should be invested in land. They are not part, nor do they represent part of the corporate property, but merely evidence the holder's interest in the corporate undertaking as a whole.

§ 331. Nature and Functions of Capital Stock.

The most important function of capital stock is the convenient representation of the stockholders' interest in the corporate business. Its division into shares enables the interest of each stockholder to be represented with much accuracy, and also enables the transfer of these interests with an ease and lack of formality that is not found under any other system of business organization.

The capital stock also serves on those rare occasions when the capital stock and the capital of a corporation are the same, to indicate the actual value of the corporate property and business. As, however, this actual value is a variable quantity and is almost always either in excess of the par value of the capital stock or below it, the utility of the capital stock for this purpose is but slight.

From the standpoint of the bookkeeper the capital stock represents an indebtedness of the corporation and is entered on the corporate books and in all general statements of the corporate affairs as a liability. This same point of view obtains in economic discussions and in some of the calculations and adjustments of commerce, in which capital stock is included under the general head of capitalization with bonds, short term notes and other obligations of the corporation as a liability. (See § 164.)

There is, however, a very sharp and clear distinction between actual corporate obligations, such as notes and bonds, and the technical liability of capital stock. Capital stock carries no interest, is never due, cannot therefore be collected by legal procedure, and, in short, is not legally a corporate liability.

From the legal standpoint the capital stock of a corporation, or more properly the assets obtained from its sale—capital stock and capital not always being clearly distinguished—is regarded as a trust fund pledged for the payment of the corporate debts. It is supposed to be the foundation upon which any credits granted the corporation are based. Hence both the common law and the statutes are insistent that no dividends shall be declared that will impair the capital stock or endanger the solvency of the corporation. (See § 255.)

§ 332. Certificates of Stock.

The ownership of stock is usually evidenced by a certificate issued by the corporation, signed by the proper corporate officials—usually the president and secretary—and sealed with the corporate seal. These certificates of stock, or stock certificates, state that the party named therein is the holder of a specified number of shares of its stock, transferable only on the books of the corporation.

The certificate of stock is a tangible and very convenient evidence of the owner's interest in the corporation, but is not the interest itself. The certificate may be lost or destroyed but the owner is still a stockholder to the same extent and with the same rights in the corporation as before. Usually the stock books of the corporation are all sufficient evidence of this fact. If, however, the stockholder wishes to sell or transfer his stock, the certificate is practically indispensable as his interest will not be transferred on the books of the corporation until his duly assigned certificate is surrendered. He must then secure a reissue of his lost or destroyed certificate. As a rule, before this will be done, a bond of indemnity must be given the corporation to ensure it against loss in case the original certificate turns up in the possession of some *bona fide* holder.

A subscriber to stock is not entitled to a certificate until he has paid the corporation the full price agreed upon for his stock. A receipt or instalment scrip should be given him for any partial payments made on his subscription. (See Form 15.) As soon as the last payment has been made, he is entitled to a certificate and can then force its issuance if necessary. In case stock is issued and outstanding and is bought from the holder, the purchaser is entitled to a new certificate upon surrendering the old certificate, duly endorsed, to the proper officer of the corporation, who is usually the secretary.

Certificates of stock have a quasi-negotiability and in practice are endorsed in blank and are then circulated freely. The holder of such a certificate—unless he is the party in whose name the certificate was issued—is not, however, a stockholder of record or entitled to any of the rights of a stockholder—except in some cases when the transfer books are closed or transfer is improperly refused—until on surrender of the endorsed certificate, the stock represented thereby is transferred to his own name on the books of the corporation. As soon as this is done, he becomes a stockholder of record, entitled to all a stockholder's rights.

§ 333. Issued and Unissued Stock.

A corporation is under no obligation to issue the full amount of its authorized capital stock. On the contrary, after any statutory requirements as to minimum issue have been complied with (See § 185 (d)), it may issue such portions from time to time as may be necessary or expedient. The stock which has been issued is termed "issued stock" and unless this comes back into possession of the corporation, it is also termed "outstanding stock." Any stock that has not been issued is termed "unissued stock."

Unissued stock has in itself no value. When issued it represents an interest in the corporate business but until that time it represents nothing more than the right of issue.

Unissued stock can neither be voted by the corporation nor can it participate in dividends, nor does it in any way affect the outstanding stock. It is not an asset of the corporation, simply because of the fact that it has no value. If it were an asset, it is obvious that a high condition of corporate prosperity might be induced at very small expense by an increase of the authorized capital stock.

Issued and outstanding stock is for bookkeeping purposes regarded as a liability of the corporation. It is, however, only a technical liability. (See § 331.) A corporation may be not only solvent but highly prosperous at a time when its actual assets are materially less than its issued capital stock.

§ 334. Stock Full Paid and Partly Paid.

A corporation may agree to sell its stock for any fair price it sees fit and when this price is paid, the corporation has no further claim against the purchaser. If, however, the agreed price is less than the par value of the stock, and the corporation later becomes insolvent, the corporate creditors can force the purchasers of such stock—if it is still in their hands—to pay the difference between the amount actually received by the corporation and the face value of the stock, or as much thereof as may be necessary to discharge the corporate obligations.

Also if stock is sold at its full face value but on instalments and these have not all been paid, the purchasers are liable to the corporation or its creditors for the balance due.

Also if stock has been issued by the corporation for considerations other than cash, and these considerations are not of the face value of the stock, the stock is not full paid. Corporate creditors may then again force payment of the difference between the actual value of the property received and the face value of the stock for which it was given, provided that the stock is still in the hands of the original purchasers, and the corporate creditors can prove the inadequacy of the purchase price and can show that the transaction was not in good faith.

If, however, the corporation has once received values in cash, property or services, up to the par value of stock issued therefor, such stock is termed full paid. Then, save as to the stock of financial institutions which is subject to special liabilities, the parties receiving such stock are not liable either to corporate creditors or to the corporation itself for any further payments on their stock. The corporation may fail and the stockholders will lose their investment, but that marks the limit of their possible loss as far as the stock is concerned.

The disquieting liability on partly paid stock makes it very desirable that stock should be full paid. In conservative corporations this end is attained by issuing the stock in exchange for actual value in money, property or labor, equal to the par value of the stock. In speculative corporations it is attempted by issuing the stock in exchange for more or less indeterminate values optimistically estimated to be equal to the face value of the stock. These estimates are usually much at variance with the real conditions, but if there is any colorable payment, the courts are inclined to hold the stock full paid. There must usually be either direct fraud or such obvious overvaluation as to amount to fraud, before the courts will hold the payment insufficient.

The liability on partly paid stock follows it into the hands of purchasers if they take the stock with knowledge of the conditions. If, however, the stock is marked " full paid " and is sold to an innocent purchaser for value, this liability does not follow it into his hands, nor unless otherwise provided by statute, does it remain with the seller, but disappears entirely.

§ 335. Payment for Stock.

In most of the states original issues of stock may be paid for in anything that has value—money, property or labor—except in the case of the stock of banks and other financial institutions, which must usually be paid for in cash.

When payment in full is made for stock purchased from the corporation, the check is usually drawn in favor of the treasurer, who then either secures the proper stock certificates and delivers them to the purchaser, or otherwise gives him a receipt evidencing his payment, and entitling him to receive full paid certificates for his stock.

If subscriptions are payable in regular instalments, or as calls are made by the board of directors, these payments are also made to the treasurer, who should either give a formal receipt for each instalment received, or otherwise give the subscriber some form of instalment scrip. If scrip is given, it is delivered to the purchaser at the time the first instalment is paid and then evidences both his subscription and amount paid thereon. As succeeding payments are made, they are endorsed upon the scrip, and when the entire amount has been paid, the subscriber surrenders his scrip in exchange for a full paid certificate of stock. (See Form 15.)

§ 336. Treasury Stock.

The term "treasury stock" is often used to designate unissued stock, on the assumption that such stock is held in the treasury of the corporation to be issued as required. The matter is purely one of verbiage, but the authorized and better use of the term is to designate "issued and outstanding stock of the corporation that has been donated to or otherwise acquired by the corporation and which is held subject to disposal by the directors."

As already stated, in speculative corporations the capital stock is usually issued in its entirety for property, a technical full payment of the stock being thereby secured. By previous agreement the parties to whom it is issued usually return a portion of this stock to the corporation, ostensibly as a donation, to be used for the purposes of the corporation. The disposal of this returned stock then lies in the discretion of the directors and it can be sold for less than its par value without involving the purchasers in the liabilities of partly paid stock. This is the most common source from which treasury stock is derived.

Also if a corporation purchases its own outstanding stock, or secures possession of it in any other way, such stock is treasury stock as long as it remains in the possession of the corporation.

From the bookkeeping standpoint treasury stock is an asset of the corporation (See § 186), though for all purposes of practical business the only difference between treasury stock and unissued stock lies in the fact that the treasury stock may be sold at less than par without involving the purchaser in liability, while with unissued stock this cannot be done.

Stock donated to the corporation which issued it, or secured in any other way, is usually assigned to the corporation in the corporate name, though occasionally it is assigned to the treasurer, or to the treasurer as trustee for the corporation. Whatever the form of assignment, such stock is the property of the corporation and, unless otherwise specially provided at the time of the donation, subject to disposal by its directors.

When certificates of stock are assigned to the corporation, they should be cancelled and the proper entries be made in the stock book to show that the stock they represent has been transferred to the corporation. It is not, however, necessary to issue new certificates as long as the stock is held in the treasury. When a sale of such stock is made, a certificate for the amount sold is issued in the name of the purchaser.

Stock owned or held by the corporation, whether treasury stock or unissued stock, can neither vote nor draw dividends.

§ 337. Common and Preferred Stock.

When all the stock of the corporation is on an absolute equality as to voting, dividends and participation in assets, it is all common stock. No one stockholder then has any right or privilege over another stockholder and no one share of stock has any advantage over any other share. They are all on a common basis and fare alike.

If, however, a certain portion of the stock of a corporation is to receive benefits not accorded all the stock, or is in some other way differentiated from the remaining stock of the corporation, such stock is termed "preferred stock," as opposed to the remaining or common stock of the corporation which has no special rights or privileges. Preferred stock is treated at some length in the succeeding chapter of the present volume.

§ 338. Watered Stock.

"Watered stock or fictitiously paid-up stock is stock which is issued as fully paid-up stock, when in fact the whole amount of the par value thereof has not been paid in. All stock which has been issued as paid-up stock, but the full par value of which has not been paid into the corporation in money or money's worth, is watered to the extent that the par value exceeds the value actually paid in. Watered stock is, accordingly, stock which purports to represent, but does not represent, in good faith, money paid into the treasury of the company, or money's worth actually contributed to the capital of the concern."[1]

As stated, any stock which is issued without property values to support it, i. e., without receipt by the corporation of money, property or labor to its face value, is watered stock. Thus a railroad company, the issued stock of which is perhaps already in excess of the real value of its property, may find its dividends so uncomfortably large as to attract public attention. Then, entirely regardless of the real values behind its stock, it will perhaps add a few millions to its capitalization and issue this increased stock in the form of a stock dividend.

[1] Cook on Corps., § 28.

No material values have been added to the capital of the corporation to serve as a basis for this increase of stock, and the value of each share of stock has therefore been diminished by the issue of the stock dividend, i. e., the stock has been diluted or watered.

CHAPTER XXXI.

PREFERRED STOCK.

§ 339. How Created.

If all the stock of a corporation is on an equality, it is all common stock. If by proper procedure some of the stock has been given rights as to dividends or assets not enjoyed by the remaining stock of the corporation, such stock is preferred stock.

In a number of the states the statutes are entirely silent as to the method of creating preferred stock. In these states preferred stock may be created by charter provision—if the statutes permit special provisions in the charter—or otherwise by by-law enactment or direct action of the stockholders. All the stockholders must, however, agree. A preferred stock issued against the wishes or without the concurrence of a portion of the stockholders would—unless permitted by the statutes of the state—be illegal.[1] If, however, all consent to give certain stock particular rights or privileges there is no legal objection.[2]

In a large number of states the statutes provide expressly for the creation of preferred stock and regulate its issue. In some of these it must be created by charter provision or amendment, as in Massachusetts and Delaware. In others. as in Maine, it may be created by by-law provision or by direct action of the stockholders. In other states, as in Kansas, it

[1] Campbell v. Zylonite Co., 122 N. Y. 455 (1890).

[2] Kent v. Quicksilver Min. Co., 78 N. Y. 159 (1879); Roberts v. Roberts-Wicks Co., 184 N. Y. 257 (1906); Toledo, etc. R. R. v. Trust Co., 95 Fed. Rep. 497 (1899).

is created only by action of the stockholders, which might, however, take the form of a by-law provision.

In some few states, as in West Virginia, it may be created by charter provision, by-law provision or by direct action of the stockholders.

When the statutes provide for or permit the creation of preferred stock by charter provision, the matter is at the time of organization merely one of agreement among the incorporators or among those who sign the charter application. When it is to be created after organization and the statutes are silent as to the method to be followed, the assent of all the stockholders is, as already stated, required. If, however, the statutes provide for the creation of preferred stock by amendment of the charter, by by-law provision or by direct action of the stockholders, it is usually specified that it may be effected by the assent of some specified proportion of the stock,[3] ranging from a bare majority as in Maine and Minnesota, or a majority in interest as in Pennsylvania, to the unanimous consent of all the stockholders as required in Kansas and Missouri.

The regulations as to the issue of preferred stock vary materially in the different states in which such provisions are found. Some of the more important of these are as follows:

(a) *Amount of Issue.* In Alabama, Delaware, Michigan, Montana, Nevada, New Jersey, New Mexico and Ohio the issue of preferred stock must not at any time exceed two-thirds of the actual paid-in capital. In Tennessee it must not exceed two-thirds of the total authorized capital stock. In Indiana it must not exceed double the amount of common stock.

(b) *Dividends.* Preferred dividends must not exceed seven per cent. in Wyoming and net earnings beyond that amount must be shared equally among the stockholders. They must not exceed eight per cent. in Delaware, Indiana, Michigan, Missouri, Montana, New Jersey and Ohio; ten per cent.

[3] Hinckley v. Schwartzschild & S. Co., 107 App. Div. (N. Y.) 470 (1905).

in Hawaii, Nevada, New Mexico and Tennessee, and twelve per cent. in Pennsylvania.

In Hawaii preferred dividends may not be made cumulative. In Nevada preferred stock dividends must be cumulative.

(c) *Assets.* In Delaware and New Jersey it is specifically provided that in case of insolvency, corporate obligations are to be paid in preference to preferred stock. In Ohio the preferred stock is given preference over common stock in distribution of assets. In Indiana preferred stock has priority at all times over common stock to the extent of its face value and arrears of interest and dividends. In Wisconsin preferred stock may not be given preference in distribution of assets.

(d) *Payment.* Every liability of unpaid stock applies in the case of preferred stock, unless removed by express statute enactment; hence there are but few statutory provisions referring specifically to payment for preferred stock. In Kentucky preferred stock may only be issued for cash or its equivalent at not less than the par value of the shares, and in Tennessee it must be paid for in cash at its par value.

(e) *Redemption.* In Tennessee and Montana preferred stock may be made redeemable at not less than par, and at par in North Carolina. In Delaware and New Mexico it may be redeemed at a fixed time and price, but not below par. In Nevada, New Jersey and Virginia it may be made redeemable at not less than par at any time after three years from date of issue. In Indiana and Michigan it must be redeemed at par on terms stated in the creating provision.

(f) *Liability of Holders.* By express statute provision holders of preferred stock in Delaware, New Jersey and Indiana are exempt from all liability for corporate debts. In Ohio preferred stockholders are liable only after the liability of common stockholders has been exhausted. In Tennessee they are not liable for corporate debts unless their stock has voting power. In Michigan preferred stockholders are exempt from personal liability for corporate debts, except debts for labor performed.

(g) *General.* In both Wyoming and Alabama preferred stock when issued must be first offered for sale to the stockholders of the company in proportion to their holdings of the common stock. In Indiana shares of preferred stock must be of the par value of $100 each and have no vote except on conveying or mortgaging real property, and on declaring dividends on the common stock to the impairment of capital, in both of which cases a majority vote of the preferred stock is necessary. In Michigan preferred stock votes as does common stock in elections of directors unless otherwise provided in the charter or amendments thereof, and if in any case the value of common stock has been impaired to the extent of ten per cent., or if dividends due on preferred stock remain unpaid for sixty days, preferred stock has equal rights with common stock in the control of the company.

In Nevada if preferred stock has received dividends exceeding seven per cent. a year, it may be converted into ten-year, seven per cent. bonds. In New Mexico, also, preferred stock may be converted into bonds on prescribed conditions by a two-thirds vote of each class of stock. In Kentucky a corporation, if all its stock is common stock, may, by a two-thirds vote of the stockholders, convert its stock into common and preferred and distribute the preferred pro rata among its stockholders. In Montana and Wisconsin the dividends, and presumably any other privileges of preferred stock, must be expressed on the face of the certificate, and in the latter state on both common and preferred certificates.

In Maryland the preferred stock authorized by the statutes of the state partakes much of the character of a bond. It may only be issued by a corporation empowered to issue bonds and must be authorized at a general meeting of stockholders. Six per cent. interest or dividends must be guaranteed out of profits and such preferred stock has preference over any subsequent mortgage.

As a rule, preferred stock is best provided for at the time of incorporation when but few people are to be consulted and an agreement as to the details of the issue is therefore more readily secured. Preferred stock is also best created by charter provision, where permissible, because of the greater stability thereby secured. It must, however, be noted that preferred stock properly issued and going into the hand of purchasers for value, no matter whether created by charter, by-laws or direct action of the stockholders, constitutes a contract between the corporation and its preferred stockholders and cannot be rescinded or recalled except by consent of all the parties interested.[4]

§ 340. Nature of Preferred Stock.

The entire trend of modern decisions involving preferred stock is toward the position that preferred stock is merely common stock with certain specified privileges. In other words, preferred stock loses none of the rights of common stock by reason of its preference, unless such rights are denied it by statute, or are withdrawn from it by the provisions under which it is created, or are superseded by its preferred rights.[5]

Thus if part of the stock of a corporation is given a preferential six per cent. dividend, this fact does not in itself disturb any of the other rights of this stock, and, unless otherwise provided by some competent authority, such stock will take precedence of the common stock as to its preferred dividend but otherwise will still vote, participate in dividends and in any distribution of assets on the liquidation of the company, just as does the common stock. The mere fact of having a preferential dividend has not in itself deprived the preferred stock of any other rights belonging to stock of the corporation.[6] Its six per cent. preferred dividend must be paid out of profits

[4] Kent v. Quicksilver Min. Co., 78 N. Y. 159 (1879); Roberts v. Roberts-Wicks Co., 184 N. Y. 257 (1906).

[5] I Cook on Corps., §§ 269, 273, 274.

[6] Boardman v. Lake Shore, etc., 84 N. Y. 157 (1881).

before any dividends may be declared upon the common stock, but if further dividends are declared in that year, the preferred stock will participate therein just as does the common stock so soon as this latter has received its six per cent.

As already stated, stock is not a liability of the corporation and, unless otherwise expressly provided by statute, this is equally true of the preferred stock and also of its preferred dividend, even though the preferred dividend were expressed as guaranteed, or as an annual interest to be paid on the specified stock. Such preferred dividend or interest can only be paid out of profits and is not a debt of the corporation until such profits have been earned and declared as dividends or interest.[7]

§ 341. Variations in Form.

Subject to any statutory regulations the preferences of preferred stock are purely a matter of agreement among the stockholders of the corporation. They may confer or deny any right they see fit, either in whole or in part. The only limitations on their powers in the matter are those of law and public policy.

Under these conditions, preferred stock is naturally issued in many different forms. Thus different classes of preferred stock may be created, the first receiving its dividends before the second, and the second before the third, and so on, all of the preferred stocks receiving their dividends in any year before the common stock may receive any dividend at all. Also these different classes may receive different rights in dividends, the first receiving perhaps five per cent., the second six per cent. and the third seven per cent. Or perhaps the amount of the preferred dividend, instead of being fixed absolutely, will be made contingent upon the amount of corporate profits earned. Or perhaps the corporate income from particular sources may be designated for payment of preferred dividends. Or it may

[7] Miller v. Ratterman, 47 Ohio St. 141 (1890); Hamlin et al v. Toledo, St. L. & K. C. R. R. Co., 78 Fed. Rep. 664 (1897).

be provided that the preferred dividend shall first be paid and the preferred stock then participate equally with the common stock of the company in all further dividends for that year. Or the preferred stock may be given preference in distribution of assets, or be given other special redemption features, or be made convertible into common stock under prescribed conditions.

On the other hand, privileges or rights may be denied. It may be deprived of the voting right. Its dividends may be made non-cumulative, or it may be strictly limited to the preferential dividend.

§ 342. Cumulative Dividends.

Dividends on preferred stock are either cumulative or non-cumulative. If, when preferred stock is created, the character of its dividend is not specified, it is held to be cumulative.

A cumulative dividend is one which, if not paid in any year, becomes a charge against the profits of the corporation and cumulates from year to year until paid. If the cumulated dividend is paid in part in any year, the balance only goes over as a charge against profits.

When a cumulative preferred stock exists, no dividends may be paid upon the common stock in any year until not only the preferred dividend for that year has been paid in full but any preferred dividends not paid in preceding years. Thus if preferred stock bears a six per cent., cumulative dividend and no dividends are paid the first year, it must receive a twelve per cent. dividend in the second year before any dividends may be paid upon the common stock. If no dividends are paid in the second year, in the third year the preferred stock must receive its full eighteen per cent. before the common stock may receive any portion of the profits.

Non-cumulative dividends, on the contrary, while a first charge on any profits declared as dividends in any one year, do not continue as a charge against the profits of following years. The claim of non-cumulative preferred stock is one which accrues to the fixed amount of the preferred dividend each year but which, if not satisfied in that year, fails absolutely and is lost.

It is obvious that a non-cumulative preferred stock offers a temptation to directors to pass dividends. If profits exist for their payment but the directors refuse to declare dividends until the following year, the dividend for the preceding year is lost entirely to the preferred stockholders and the amount thereby saved to the corporation inures principally to the benefit of the common stockholders. This feature is discussed at some length in a preceding portion of the present volume. (See § 254.)

§ 343. Rights to Assets.

Stockholders of a corporation have no individual rights in its property save when profits are distributed as dividends or when on the dissolution of the corporation its assets, after payment of all debts, are distributed among the stockholders. Preferred stock has exactly the same rights in any such distribution of the assets as has the common stock unless otherwise expressly provided.

In order to add to the safety and attractiveness of preferred stock, it is usual to give it preference in any final distribution of assets. In a few states the statutes provide for such preference. If, when such preference exists, the corporation is liquidated at any time, the debts of the corporation must first be paid. Next the preferred stock must receive its full face value. The common stock will then receive its full face value, and both preferred and common stock will participate equally in any assets which may still remain. Any of these features as between the preferred and common stock may be modified by express provision, as for instance, the preferred stock might be denied any further participation in assets after its full face value is once received.

§ 344. Voting Rights.

Preferred stock has all the usual voting rights of stock unless these are expressly denied it in whole or in part. In some few states, as already noted (See § 339), the voting right of preferred stock is prescribed or restricted by statute. In other states it depends entirely upon the conditions under which the stock is issued. Very frequently the voting right is taken from it absolutely and it then has no voice in the general management of the corporation. At other times the voting right is not denied absolutely, as where it is provided that the preferred stock shall not vote as long as its preferred dividend is paid in each year, but if this fails in any year it shall be entitled to vote.

There are but few states in which statutory restrictions exist as to these variations of the voting right of preferred stock, and, speaking generally, the matter is one entirely within the discretion of the stockholders.

§ 345. Redemption Rights.

Not uncommonly the provisions creating preferred stock provide that it may be redeemed at some specified period and price. Thus a preferred stock will be issued with a redemption clause providing that at the end of five years the corporation may redeem it at par or at some percentage above this par value. Usually the redemption price is in excess of the par value, ranging between par and 110.

In some states the statutes require that preferred stock shall be made redeemable at a fixed time and at a price not less than par. (See § 339.) In most of the other states proper redemption provisions are allowable, and in some are expressly permitted by the statutes. A redemption provision would not, however, be possible in a state where corporations are prohibited from acquiring their own stock. Usually also the redemption must be made from profits.

For obvious reasons redemption clauses are usually made permissive rather than mandatory, stating that the stock may be redeemed at the specified price at any time after the prescribed date, or within a specified period. Then the corporation may exercise its discretion as to whether the stock shall be redeemed or allowed to stand.

The redemption right is at times of material advantage to a corporation. The dividend rates on preferred stock are usually higher than the interest rates on borrowed money, and if the corporation is prosperous and accumulates a surplus which can be used for the retirement of the preferred stock, or if it can legally borrow money for the purpose, the privilege of retirement may be highly advantageous.

Thus a corporation can ordinarily borrow money at from four to six per cent. Dividends on preferred stock usually range from six to eight per cent. If, then, a corporation retires its preferred stock with money either taken from its surplus or secured from the sale of bonds—if such redemption is permitted by the state laws—which bear a rate of interest less than the rate of the preferred dividend, there is each year a direct and usually material saving.

If the redemption period for preferred stock is short, this feature may detract from the desirability of the investment and affect the sale of the stock injuriously. To counterbalance this the redemption price is usually placed above par. Then an early redemption involves a substantial profit to the holder of the stock and presumably compensates him for the disturbance of his investment.

When preferred stock is to be redeemed, the payment of any cumulative dividends is a prerequisite. The redemption clause is usually phrased in recognition of this fact, providing that the stock shall be redeemed at the specified price plus any accrued dividends.

Preferred stock when redeemed, so long as it remains in the hands of the company, is no longer a claim against the dividends or assets of the company nor does it enjoy any voting rights. It cannot, however, be cancelled so as to reduce the corporate capitalization unless this is expressly permitted by the statutes of the state, but remains a part of the corporate capitalization and might with the consent of the stockholders be reissued.[8]

§ 346. Convertible Stock.

Preferred stock is sometimes issued which gives the holder the privilege of exchanging it for common stock either at some specified time or within a specified period, the terms of exchange being prescribed.

When preferred stock is non-participating, i. e., does not participate in dividends beyond its preferred dividend, the convertible privilege adds materially to its attractiveness Its preference as to dividends and as to assets, if this also belongs to it, gives it a safety and an assurance of annual returns that is not characteristic of common stock. The convertible feature gives in addition an opportunity for an advantageous exchange for common stock, if the corporation so prospers as to make this exchange desirable. In other words, the safety of preferred stock is combined with the speculative possibilities of common stock.

Sometimes a convertible feature is created between preferred stock and bonds, as in the case of the United States Steel Corporation's seven per cent. preferred stock and its five per cent. bonds. The exchange in this case was made under the provision of a special enactment of the New Jersey legislature, and a large amount of preferred stock was replaced by the bonds, the exchange converting a seven per cent. cumulative dividend into a five per cent. interest obligation. As the cumulative dividends on the preferred stock of the United States Steel Corporation have always been regularly paid, the advantages of the exchange are obvious.

In the absence of express statutory provision, any such

[8] Berger v. U. S. Steel Corp., 53 Atl. Rep. 68 (1902); Hackett v. Northern Pac. R. R. Co., 36 N. Y. Misc. Rep. 583 (1901); City Bank of Columbus v. Bruce & Fox, 17 N. Y. 507 (1858).

exchange of stock for bonds or agreement for such exchange would usually be illegal. The procedure is in effect borrowing money to retire the stock of the corporation.

§ 347. Guaranteed Stock.

The term "guaranteed stock," as applied to preferred stock, merely means a cumulative preferred stock. The expression usually designates preferred stock in which the dividends are "guaranteed" by the terms of the creating provision. There is no special virtue in the expression or in the stock, as ordinarily it is held to be merely a cumulative preferred stock. In spite of the statement of the creating provision that the dividend is guaranteed, such dividend can only be paid out of profits, and if no profits exist, it is in no way a debt of the corporation. The unpaid dividend merely passes over and cumulates as does any other cumulative dividend until such time as profits exist and are declared as dividends for its payment.

The usual and better application of the term "guaranteed stock" is to stock on which the dividend or principal has been actually guaranteed by some person, concern or corporation other than the issuing corporation. Such stock is frequently created when a railroad takes over a subsidiary line and guarantees either dividends or principal, or both dividends and principal of the stock of the absorbed road. The dividend on the guaranteed stock then becomes an actual obligation of the guaranteeing road which must be met when due as is any other interest or obligation.

§ 348. Liabilities of Preferred Stock.

Special exemptions from liability have been given preferred stockholders in some few states (See § 339) but in most states of the Union the liabilities of preferred stock are the same in every respect as those of common stock. If the stock is full paid, it carries no liabilities. If it is but partly paid, the subscriber is liable in event of the insolvency of the corporation, to be called upon for the amount necessary to make his stock full paid. In any case, if the certificates are marked "full paid" and are not in the hands of the original subscribers but of parties who have bought them in good faith, they carry no liability of any kind even though the stock they represent has in fact not been fully paid.

§ 349. Advantages of Preferred Stock.

The numerous possible variations of preferred stock make it available for many different purposes. The most important reason for creating preferred stock is perhaps to provide a corporate security which can be sold more readily than ordinary stock. For this purpose preferred stock may be made to offer greater safety both as to principal and dividends than does common stock. Its preferred dividend gives it the first claim on profits. A preference as to assets gives it a first claim on the assets of the company when the corporation is liquidated. Also if in addition to its preferential dividend the preferred stock participates with the common stock in any further dividends declared, the preferred stock offers the same speculative possibilities as does the common stock but with a much greater safety. Such stock is therefore more desirable than common stock and is much more readily sold.

Preferred stock not only offers a corporate security which may be made more desirable and therefore more readily salable than common stock, but when properly adapted may be used to great advantage in meeting the many and various contingencies arising in the industrial world. Thus preferred stock is frequently issued to represent or pay for the actual property assets taken over by the new corporation, while common stock is issued to represent the goodwill and other intangible assets. Or when a partnership is incorporated, the excess investment of one partner is frequently represented by an issue of non-voting preferred stock while the interest of a silent partner is conveniently cared for by the same means. Or in a consolidation the values or interests of the various properties combined are adjusted and represented by the help of preferred stock.

When money is to be raised for corporate purposes, the relative merits of preferred stock and bonds frequently come into question. In this case the main point in favor of preferred stock is usually found in the conditional nature of its claims upon the corporation. It is not a debt of the corporation either as to dividends or principal. Unless the stock is redeemable, the principal is never due. The dividend is due if profits exist for its payment, but if it is not paid in any year it merely passes over to succeeding years if cumulative, or expires if non-cumulative. In any event, it is merely a claim against profits.

Bonds, on the other hand, are an absolute obligation of the corporation both as to interest and principal. If the interest is not paid when due it may be collected by legal proceedings and frequently default in interest has the effect of maturing the bond and thereby rendering payment of both principal and interest imperative. The bond must, in any event, be paid at maturity under penalty of foreclosure, regardless of the condition of the corporate finances.

On the other hand, preferred stock to be salable must usually be given a larger preferential dividend than the interest that would attach to a bond salable under the same conditions. Hence it becomes a question as to which is preferable,—the absolute obligation of the bond with its lower interest, or the absolute freedom from liability of preferred stock with its higher dividends. If a company is established and prosperous, the bond issue is undoubtedly preferable. Under any other circumstances, the preferred stock is as undoubtedly the better choice.

CHAPTER XXXII.

BONDS.

§ 350. Nature of a Bond.

When a corporation borrows money, its indebtedness may be evidenced either by notes or bonds. If the amount borrowed is small, or if it is borrowed in a single sum, or but from few persons, or for a short time, notes are usually given. If, however, the amount is large and obtained from a number of people and extends over a period of years, the corporate obligation is preferably and usually evidenced by bonds.

The difference between a corporate note and a bond is not always clearly marked. Both are promises to pay money. The phrasing of the bond is usually more formal than that of the note. Also it must be executed under seal while the corporate note need not. Also payment of bonds is usually, though not invariably, secured as to both principal and interest by certain specified property held for the purpose under a formal deed of trust.

A bond payable to order, or bearer, or holder is a negotiable instrument (See § 259) and this in spite of the fact that it is executed under seal (See § 267.) Hence if such a bond is in due form and is purchased for value and in good faith, the purchaser is protected against any defenses set up by the corporation and against any claims of previous owners.

A bond issue consists of a number of bonds which, while they may vary as to denomination, and some may be registered and some unregistered, are all of like general tenor, and, if secured, are all secured and, unless otherwise expressly provided, equally secured under one deed of trust.

Bonds are issued in varying denominations. $1,000 is the usual face value; $500 bonds are not infrequently issued; $100 bonds are occasionally seen, and bonds are sometimes issued for popular subscription of still smaller face value. Bonds of a face value of $5,000 and $10,000 are frequent, and larger denominations are not uncommon.

Bonds are a direct corporate obligation and do not in any way partake of the nature of stock. They may, however, be given rights of participation in corporate profits if desired, and, in the absence of statutory prohibition, may be given voting rights as well.

§ 351. Authorization of Bond Issues.

"The power of a corporation to borrow money is implied and exists without being expressly granted by charter or statutes."[1] In the absence of restraining laws, a corporation may therefore issue corporate notes and bonds to any desired amount.

Also, unless otherwise expressly provided by law, the power to incur corporate indebtedness lies with the directors and they may at their discretion issue the corporate notes and bonds without authorization from the stockholders.

In most states, however, constitutional or statutory provisions are found directly limiting or otherwise affecting the common law right of corporations to borrow money or incur debt, particularly by the issue of bonds, and in many states statutes prohibit the directors from issuing bonds until authorized thereto by the stockholders.

[1] Cook on Corps., § 760.

§ 352. Statutory Provisions.

Constitutional provisions affecting the issue of bonds are found in many states but as a rule confine themselves to the requirement that bonds shall only be issued for value and that any fictitious increase of indebtedness is void. In a few states the constitution requires the authorization of bond issues by stockholders.

Statutory provisions limiting the amount of corporate indebtedness are found in many states. Thus in Florida, Kentucky, Minnesota and some other states, the maximum corporate indebtedness that may be incurred must be stated in the charter. In Colorado, California, Idaho, Illinois and a number of other states the corporate indebtedness must not exceed the amount of the capital stock. In other states, as Nebraska and Vermont, the corporate indebtedness must not exceed two-thirds of the capital stock. In New Hampshire it may not exceed one-half the value of the corporate property.

Provisions requiring the assent of a specified majority of the stockholders before bonds may be issued are also found in many states. Thus in California, Nevada, New York and other states, a bond issue must be authorized by a two-thirds vote of the stockholders. In Alabama, Missouri, Pennsylvania and a number of other states, it may be authorized by a mere majority of the voting stock. In Ohio a three-fourths vote of the stockholders is required before convertible bonds may be issued. The statutory provisions also frequently specify the notice which must be given for stockholders' meetings to authorize bond issues.

In some states specific provisions exist as to the selling price of bonds, as in North Carolina where the statutes provide that bonds may be sold below par and commissions may be paid upon the sales, or in Wisconsin where the true value of the money, labor or property received for bonds must be at least 75 per cent. of their par .value. The Wisconsin provision, it must be added, is somewhat weakened by the further enactment that, notwithstanding its terms, bonds may be sold at the best price obtainable on the stock exchanges of Chicago, New York, Boston or Philadelphia.

Special provisions as to bond issues are found in some states, as in Louisiana, New Mexico, Nevada, Missouri, New Jersey and Ohio, where the statutes expressly authorize the issue—under proper procedure—of bonds convertible into stock, or in Delaware where bondholders may be given the same rights as stockholders, or in Nevada and Virginia where by proper procedure bondholders may be given the right to vote. It may be noted that in Illinois, on the contrary, the courts hold that bondholders cannot be given the right to vote at corporate meetings.

§ 353. Debentures.

The payment of corporate bonds may either be secured or unsecured. If unsecured, the bonds are usually termed "debentures." This use of the term is not, however, invariable, as a certain class of bonds secured by collateral are at times similarly designated.

The usual unsecured debenture bond is merely the formal corporate promise to pay money. It is an obligation of the corporation but, as it is unsecured, there can be no foreclosure in case of default on either interest or principal. It is merely an unsecured debt of the corporation, taking no precedence over any other unsecured debt. Its claim is superior to that of preferred stock but is inferior to that of any secured indebtedness of the corporation. Its value depends entirely upon the financial strength of the issuing corporation.

As stated, a certain class of secured bonds are sometimes styled debentures. To secure payment of these bonds certain of the corporate assets—usually stocks and bonds of other corporations—are deposited with a trustee under a trust agreement. The bond is then in effect a collateral note and is frequently termed a "collateral trust bond."

§ 354. Mortgage Bonds.

A mortgage bond is one the payment of which is secured by a mortgage or deed of trust on part or all of the property of the corporation. This deed of trust usually authorizes the trustees, in case of default on interest or principal of the secured bonds, to take possession of the property and either operate it or sell it, as may be provided, for the benefit of the bondholders.

"Mortgage" bonds are first mortgage, second mortgage, etc., according to the lien of the deed of trust by which they are secured. Thus a first mortgage bond, as its name indicates, is a first lien on the property covered by the deed of trust, while a second mortgage bond secured on the same property is a second lien, i. e., in case of foreclosure the first mortgage bonds must be paid in full, both principal and interest, before the holders of the second mortgage bonds receive anything. Hence, first mortgage bonds are more desirable than those of a junior lien, i. e., those of an inferior or later lien, unless the property is of such value as to be an absolute and unquestionable security for the entire amount of outstanding bonds. (See § 369a.)

§ 355. Coupon Bonds.

Coupons are in effect promissory notes, each calling for the payment of one instalment of interest on a bond. A coupon bond is one to which such coupons are attached, each coupon requiring payment on its due date of the interest instalment represented by that particular coupon. The interest on such bonds is payable to the holders of these coupons and not to the holder or owner of the bond.

Interest on bonds is usually payable semi-annually, and each of the coupons attached to a coupon bond calls for the exact amount of one of the semi-annual interest payments on that bond. (See Forms 36 (b), 41.) Thus a bond running ten years with interest payable semi-annually, would have attached to it twenty coupons. Each coupon is numbered to correspond with its bond but also has a serial number—running from one to twenty in the instance cited—indicating the order in which the coupons come due. (See § 358.)

Coupon bonds are usually made payable to bearer, though sometimes registered as to principal, and the coupons are also payable to bearer and pass by delivery when clipped from the bond.

§ 356. Registered Bonds.

A registered bond is one issued in the name of some particular person in the same manner as is a certificate of stock, the bond thereafter being transferable only on the books of the company. (See Form 42.)

Coupon bonds, as stated, are usually payable to bearer and are then transferable by mere delivery. Sometimes, however, they are issued in registered form as to principal but the coupons are still made payable to bearer. The interest then is paid to anyone who presents the coupon, but the principal will only be paid to the person in whose name the bond stands on the books of the company, or to his assignee.

Bonds without coupons are always registered, are transferred only by assignment, interest is payable to the registered owner alone and is usually paid by checks sent out to these registered owners.

Coupon bonds payable to bearer and registered bonds are often issued under the same deed of trust. Usually when this is done, the two classes of bonds are made interchangeable, i. e., any holder of a coupon bond payable to bearer may at any time exchange it for a registered bond, or the owner of a registered bond may at any time exchange it for a coupon bond payable to bearer.

The advantage of an unregistered coupon bond is found in the readiness with which it may be transferred. The advantage of a registered bond lies in the difficulty of its negotiation in case the bond is lost or stolen. If a bond payable to bearer is either lost or stolen, its sale or disposal is comparatively easy, and, once in the hands of an innocent holder for value, the stolen bond is valid. A registered bond, on the contrary, should it be lost or stolen, is practically non-negotiable. It is payable only to the party named in the bond and a successful negotiation of the bond involves a forgery of his signature which would effectually prevent a valid transfer.

When registered bonds are assigned, the assignee surrenders the old bond and receives in exchange a bond issued in his own name, the new ownership being recorded upon the books of the company at the same time.

§ 357. Form of Bond.

The language of a bond is usually more formal than that of a note, it must be executed under seal, and, if secured, reference is made in the bond itself to the deed of trust under which it is issued.

Usually a statement of the general conditions of a bond issue appears upon the face of each bond and reference is made to any features of special importance, such as the existance of a sinking fund, the conditions of redemption, the method of transfer and exchange when bonds payable to bearer and registered bonds are issued under the same deed of trust, etc., etc.

§ 358. Form and Nature of Coupon.

A coupon is in form a promissory note. (See Forms 36 (b), 41.) It is attached to the bond as a convenient method of indicating the amount and the due date of interest and for its collection when due. One coupon is attached to the bond for each interest instalment. Thus a twenty-year bond with semi-annual interest payments would carry forty coupons. These coupons are numbered serially and also carry the number of the bond to which they are attached. Coupon No. 1 represents the interest that will be due at the first interest period. As soon as that period arrives the coupon matures and it is then detached from the bond and either presented for payment or deposited for collection as would be done with any other promissory note.

Coupons may be detached from the bond before maturity, and may be sold independently of the bond. The possession of the coupon is sufficient evidence of ownership in the absence of proof to the contrary, and as a coupon is payable to bearer, no endorsement is necessary or usual when it is presented for payment or deposited for collection.

When an interest payment on coupon bonds is about to fall due, the amount necessary to meet the maturing coupons is usually deposited in some designated bank which acts for the corporation and pays the coupons as they are presented. The coupons are then cancelled and are pasted in the coupon register. (See § 95.)

§ 359. Trustee's Certificate.

Bonds issued under a deed of trust must usually be certified by the trustee before they are issued. The trustee's certificate appears on the back of each bond, and evidences the fact that the bond is one of the issue mentioned in the deed of trust. (See Form 43.) As a rule, the object of this certificate is merely to identify the bond and to prevent overissues. If the trustee certifies more bonds than are called for by the deed of trust, he may make himself personally responsible for the overissue, but otherwise he incurs no liability whatsoever by reason of his certification.

A certification is not part of the bond, though it may be required before the bond itself can be considered as issued, nor is it in any sense an endorsement of the bond nor a certification of its correctness as to form or subject matter.

§ 360. Deeds of Trust.

A deed of trust is a mortgage on certain specified property given to a trustee who acts for the holders of the bonds secured thereby. The deed of trust recites at length the terms and conditions under which the bonds are issued and under which the property for their security is held. (See Form 44.)

A modern deed of trust is usually a very comprehensive and formidable instrument. A brief form may occupy perhaps from ten to twenty pages of printed matter. More extended forms frequently occupy one hundred pages or more.

In the bond itself reference is always made to the deed of trust by which it is secured, and in the deed of trust the bond is recited in full. The bond by express terms is subjected to the conditions of the deed of trust. Accordingly the statements of the bond are controlled by the explanations and any non-conflicting conditions of the deed of trust. If, however, the terms of the bond and of the deed of trust conflict, the bond prevails.[2]

If the deed of trust fails for any reason, the bonds then become the unsecured obligation of the corporation and take their place on a parity with the other unsecured corporate debts.

§ 361. Recitals of Deed of Trust.

In the deed of trust usually employed the preamble recites the conditions precedent to the issue, the form of bond in full, and the form of coupon and trustee's certificate, also in full, followed by the granting clauses, including description of property covered, and by the trust reservation with stipulation for equal participation of all the bonds of that issue in the protection afforded by the mortgaged property.

Following this come the "covenants, conditions, uses and trusts" subject to which the bonds are issued and the mortgaged property is held. These have a wide range. Some of the more usual are as follows: (1) Procedure for execution, certification and delivery of bonds; (2) enjoyment of property by mortgagee until default; (3) payment of principal and

[2] Railway Co. v. Sprague, 103 U. S. 756 (1880).

interest without deduction for taxes, and in "gold coin," "legal tender" or otherwise, as the case may be; (4) payment of all taxes and assessments on property held under the deed of trust and, if the nature of the property is such as to require it, maintenance of the same in repair, under due insurance and free from liens; (5) provision that the deed of trust shall be a first mortgage—if such is the case—and be duly executed, recorded and maintained; (6) provision for any necessary additional assurances for protection of bondholders; (7) provision for trustee to enter upon property and conduct business without foreclosure under certain conditions; (8) sinking fund for retirement of bonds; (9) procedure for foreclosure in case of default; (10) provision that bonds shall be matured by failure to pay interest; (11) stipulation that loans, advances or payments made on coupons for account of the mortgagee shall not keep such coupons alive; (12) provision for redemption of bonds; (13) provision for discharge of deed of trust; (14) provision for substitution or appointment of new trustee; (15) disclaimer of responsibility on part of trustee; (16) interpretation of terms used in deed of trust; (17) provision that deed of trust may be executed in duplicate parts.

In addition to these common provisions, others are often dictated by particular conditions. Thus if both registered and coupon bonds are issued, provision must be made for registration and for the exchange of one for the other if this is prescribed; also provisions may be inserted for the issue of temporary certificates, or for replacement of destroyed or mutilated bonds, or for discrimination against coupons detached or assigned before maturity, or for exemption of the stockholders and officers of the issuing company from all liability under the deed of trust or for the bonds issued thereunder; or in a mortgage on realty it may be provided that upon payment to the trustee of a certain specified price, parts of the property may be sold free from the incumbrance of the mortgage, or that under prescribed conditions properties may be withdrawn from the mortgage and new properties substituted in their place.

The duties of the trustee under a deed of trust are usually few but may be onerous. He certifies each bond issued. At times the recording of the deed of trust is made one of his duties. In case of default he is usually required either to take possession of the property and operate it or sell it, according to the conditions of the deed of trust, for the benefit of the bondholders. If called upon to operate the property, his duties and liabilities may be heavy. If the property is operated at a loss, he may be responsible for the deficit.

§ 362. Execution and Filing of Deed of Trust.

The deed of trust is executed with the same formality as a deed of land. It must be signed and sealed both by the corporation and by the trustee, and be duly acknowledged before a notary public or other duly authorized officer. The corporate signature is usually affixed by the president and the corporate seal is affixed and attested by the secretary. The acknowledgment is also usually made by the president of the corporation, but is of equal force if made by the secretary, treasurer or any other duly authorized executive officer. It is immaterial whether the deed of trust be executed within the state in which the corporation was organized or elsewhere.

If realty is included the deed of trust must be filed in the office of the county clerk in every county in which the real estate is situated.

§ 363. Sinking Fund.

A sinking fund as applied to bond issues is a fund created for the purpose of redeeming the bonds when due, or prior thereto, as may be provided by the deed of trust. Thus bonds may be retired from time to time as the sinking fund accumulates, or the fund may be allowed to remain intact until the maturity of the bonds, when, if properly constituted and maintained, it is sufficient for the retirement of the issue.

Sinking fund requirements will vary with the conditions. Sometimes a stated annual amount is paid into the fund. At other times the income from a certain source will be devoted to this purpose. Coal mining companies frequently reserve a certain amount for each ton of coal mined. Lumber companies sometimes reserve a certain amount on each thousand feet of lumber cut.

In the smaller corporations the sinking fund is usually informal and is kept in the custody of the corporation. For the larger bond issues, a sinking fund is usually established in the hands of a special trustee, who holds it subject to the conditions of the deed of trust.

The wisdom of a sinking fund is, in the case of most bond issues, apparent. Reserving as it does a moderate amount each year for the payment of the bonds, their final redemption is effected with comparative ease. Without such a fund another bond issue to retire the maturing bonds, or a default, would be the probable result.

In the case of railroads there is a tendency to dispense with sinking funds when bonds are issued for permanent additions or improvements, the bonds when due being replaced by a second issue. This is based upon the principle that the additions or improvements being permanent and being maintained out of earnings, are as much for the benefit of subsequent as of present stockholders and that the present stockholders should not be deprived of their dividends merely to provide a more valuable property and larger dividends for those who come after.

§ 364. Sale of Bonds.

Unless prevented by statutory enactment, bonds may be sold at any price that can be obtained. In most of the states there are provisions that bonds may only be issued for value actually received, but, in the absence of some more specific limitation, bonds may still be issued below par if in good faith. In some few states more specific provisions exist. (See § 352.)

The sale of bonds below par by the issuing corporation may, however, constitute an infraction of the laws against usury. Thus if a 5 per cent. bond of the face value of $1,000 be sold for $500, the rate of interest paid on the money so secured is 10 per cent. If, then, this exceeds the legal rate of interest in the state in which the sale was made, the transaction is usurious and illegal, and for this reason the original purchaser, or subsequent purchaser knowing the conditions, might be unable to enforce the payment of his bond. This could not, however, be the case if the bonds were in the hands of an innocent holder for value, nor in states in which the statutes are silent as to usury, nor in states where bonds may by statute provision be sold below par, nor in states where corporations are not allowed to avail themselves of the defense of usury.

§ 365. Liabilities of Vendor.

The vendor of a bond does not warrant the legality of the issue nor in any way guarantee payment of the bond. All he undertakes is that as far as he has knowledge the bond is legally issued and what it purports to be, that it has come into his hands in due course and for valuable consideration and that he is legally competent to transfer it to the purchaser. In this the bond differs from a note, draft or check, which the vendor is held to guarantee unless assigned "without recourse."

§ 366. Rights of Holders.

A bond as a negotiable or quasi-negotiable instrument, is not subject to the defenses that might exist between the original parties. In practice, "the courts go very far in protecting *bona fide* holders of corporation bonds, and will uphold and enforce such bonds under nearly all circumstances. The defense that the bond was issued below par does not avail as against a *bona fide* holder."[3]

A first mortgage bond does not lose its priority though issued after a second mortgage bond. Nor does the number or date of issue of a bond in any way affect its rights of payment as regards the other bonds of the same issue unless expressly so provided by the bond or the deed of trust. Such provisions are legal but unusual and, as a rule, every bond of an issue has all the rights of any other bond of that issue.

Bonds cannot be paid by the issuing corporation before they are due save by consent of the holders, unless there is express provision in the deed of trust for such prior redemption. Nor can the corporation deposit sufficient money with the trustee for the redemption of the bonds and cancel the mortgage. It may, of course, deposit the money for the payment of the bonds, but the deed of trust remains in force, and should the deposited money be lost before the bonds mature, the corporation must again provide for their payment. If, however, at the maturity of the bonds, all are not presented for payment, the trustee may reserve a sufficient amount of money for the retirement of the missing bonds and discharge the deed of trust.

Coupons may be detached from their bonds before maturity and be sold separately if the bond is negotiable, but otherwise not. The holder of a negotiable bond or a negotiable coupon, i. e. one payable to bearer or holder or order, is always presumed to be the *bona fide* holder of such bond or coupon until the contrary is proved, and, in the absence of any suspicious circumstances, the corporation may safely take up the instrument and pay the amount due thereon to the holder. Nor would it thereafter be liable, even should it be shown that the holder was not the rightful owner of the bond or coupon.

The pledgee of registered bonds may have them trans-

[3] Cook on Corps., § 766; also Dickermann v. Northern Trust Co., 176 U. S. 188 (1900).

ferred to his own name and may collect the interest or coupons on the pledged bonds as the same becomes due, but must apply all money so received against the debt.

Suit may be brought on a bond or coupon if not paid at maturity just as suit may be brought on a promissory note, and this even though the mortgage is not foreclosed. In case of judgment, however, no execution may be had against the mortgaged property. In some few states, as in New Jersey, such suit by the individual holders before foreclosure is forbidden by statute.

In case of foreclosure, if the property held under the deed of trust is not sufficient to pay the bonds secured thereby, the bondholders have recourse against the corporation for the balance due.

§ 367. Redemption of Bonds.

The date of maturity of bonds is stated in the deed of trust and also on the face of each bond. The deed of trust also usually provides that if any instalment of interest is not paid when due and the default continues for some specified length of time, the principal of the bond is thereby matured and must be paid.

In event of default either on principal or interest, it is usually provided that foreclosure may follow or perhaps, preliminary thereto or in lieu thereof, the trustee is authorized to take possession of the mortgaged property and operate it for the benefit of the bondholders.

When bonds are redeemed in accordance with the terms of the deed of trust, they are cancelled and cannot be reissued unless expressly so provided in the deed of trust. A corporation might, however, purchase its bonds in the open market and sell them again later.

In some cases provision is made in the deed of trust for redemption of bonds prior to the maturing date, as discussed under the head of "Redeemable Bonds" (§ 369e) Also convertible bonds are at times issued which, if the holder elects, may be redeemed in stock of the corporation, as discussed under the head of "Convertible Bonds" (§ 369d). Also at times it is provided that as the sinking fund accumulates, the funds may be used from time to time to redeem the outstanding bonds, as discussed under the head of "Sinking Fund" (§ 363).

§ 368. Investment Value of Bonds.

If bonds are purchased at par, the return on the investment is the exact interest paid on the bond. If, however, bonds are purchased either above or below par, the determination of the actual return on the money invested becomes somewhat difficult.

Thus if a $1,000 bond due in ten years and bearing interest at the rate of 5 per cent., is purchased at $900, it is obvious that the direct interest on the investment is considerably in excess of 5 per cent., amounting to 5 5-9 per cent. In addition to this, when the bond is paid at maturity, its full face value of $1,000 is received giving a further return or profit of $100 on the original investment.

On the other hand, if the bond is purchased at a premium, say at $1,100, the direct interest returns are but 4 6-11 per cent., and on maturity of the bond the purchaser receives but $1,000 which is $100 less than the price he paid for his bond. There is therefore a double loss,—both on interest and principal.

A rough approximation of the returns on the investment when bonds are purchased at a discount or at a premium, may easily be made, but if exact results are to be reached—which are required when large investments are to be made—the calculations are laborious. For use in such cases bond tables may be purchased from which the actual investment value of any ordinary bond, whether sold at a discount or at a premium, may be found at any period of its life.

§ 369. Kinds of Bonds.

Many classes of bonds are issued under varying designations, usually derived from the more important or distinctive features of the particular issue. The bonds most frequently issued, are briefly discussed in the present section.

Bonds frequently possess the characteristic of several different classes. Thus the bonds of the United States Steel Corporation given in Forms 40 and 42, and known as "ten-sixty-year five per cent. sinking fund gold bonds," are redeemable at any time after ten years from date of issue at the option of the corporation; their payment is provided for by a sinking fund and they are payable in gold coin. Also, if not previously redeemed, they must be paid at the end of sixty years, and bear 5 per cent. annual interest. All this is indicated by the name.

(a) *First Mortgage, etc. Bonds.* A first mortgage bond is one secured on property upon which no other bonds or similar obligations are secured. (See § 354.) Usually a first mortgage bond is a first lien on the property by which it is secured, though this is not invariably the case, as for instance, a builder's lien upon property covered by the deed of trust takes precedence over the bonds.

A number of bonds may be secured by the same property. In such case, the first issue is, as stated, a first mortgage bond; the next a second mortgage bond; the next a third mortgage bond, etc., the lien of each of these latter being inferior to that of the bond or bonds which precede it, but superior to that of the bond or bonds which follow.

(b) *Junior Lien, etc. Bonds.* A junior lien bond is one which comes after, or is inferior to some other bond or bonds in its lien upon the property by which it is secured. Thus the lien of a second mortgage bond is a junior lien to that of the first mortgage bond.

When several different issues of bonds are secured by the same property, those having the superior lien are sometimes styled underlying bonds. the term indicating that they are closer to the property and have a superior claim. Thus if first and second mortgage bonds are secured on the same property, the first mortgage bonds are underlying bonds. If third mortgage bonds are also issued, both first and second mortgage bonds are underlying bonds.

(c) *Gold, etc. Bonds.* A bond may in express terms provide for payment in gold, silver, legal tender money, etc. Such provisions are legal and enforceable. If no medium is specified in which payment of a bond must be made, legal tender is always understood.

(d) *Convertible Bonds.* A convertible bond is one which under prescribed conditions carries the right of conversion into other securities of the same corporation. The usual form of convertible bond is that which may be exchanged for common or preferred stock of the issuing corporation at a fixed rate of exchange and within a certain period.

Thus the Pennsylvania Railroad issued in 1905 a ten-year 3½ per cent. gold convertible bond. (See Form 37.) This bond is exchangeable at the option of the owner, at its face value for stock of the company at the rate of $75 per share until the redemption of the bond. The par value of the Pennsylvania stock is but $50 per share and it must therefore be taken at a premium of 50 per cent. if the exchange is made. At the present time the stock of the Pennsylvania Railroad Company is selling at a price materially below the conversion figure. The convertible bonds are also selling below par, but not sufficiently so to make the exchange profitable.

It is obvious that the conversion privilege gives a bond a speculative character which adds greatly to its attractiveness as an investment. If the stock of the issuing company advances materially, the exchange can be made at a profit. If the stock does not advance, the bonds themselves are still a good investment. In short, the plan combines the safety of a bond investment with the profit possibilities of an investment in stock.

(e) *Redeemable Bonds.* Redeemable bonds are issued with the proviso that the issuing corporation may redeem them before the arrival of the date of maturity fixed by the deed of trust. Thus the ten-year 3½ per cent. gold convertible bond of the Pennsylvania Railroad Company already referred to, may be redeemed at par and accrued interest at the option of the Railroad Company "on December 1st, 1910 or on any subsequent interest day on ninety days' notice," notwithstanding the fact that the maturity date is October 1st, 1915.

Frequently when the redemption privilege is retained by the issuing corporation, it is provided that a premium shall be paid upon the bonds redeemed before maturity which are usually selected by lot. Thus the sinking fund provision of the deed of trust securing the ten-sixty-year five per cent. sinking fund gold bonds of the United States Steel Corporation, provides that at any time after ten years from the date of issue, any outstanding bonds may be redeemed by payment of the principal and a premium of 10 per cent. of such principal together with all accrued interest, bonds redeemed to be selected by lot and redemption to be confined to coupon bonds until all outstanding coupon bonds shall have been redeemed.

(f) *Profit-Sharing, etc. Bonds.* Profit-sharing bonds, or dividend bonds, or participating bonds, as they are variously termed, are bonds which in addition to their regular interest are entitled to some participation in the dividends of the company. The dividends paid on a profit-sharing bond may be limited to a fixed amount or percentage, or be conditioned otherwise or the bond may participate as fully as does the common stock of the company.

It is obvious that such a provision gives the bond a speculative character which adds materially to its attractiveness as an investment. If it participates fully on the same basis as does the stock of the corporation, it has all the safety of a bond with all the profit possibilities of stock and is preferable to a convertible bond because the bond features do not have to be sacrificed to secure the profit-sharing stock possibilities.

(g) *Income Bonds.* An income bond is one which relies upon the net income of the company for its interest payments. It is a lien on the net income, but, unless profits are earned, its interest is not an obligation of the company. Such bonds differ from preferred stock only in the fact that their principal is an absolute obligation of the company and must be paid at the maturity date.

Income bonds may be either cumulative or non-cumulative as to interest. (See § 342.) The principal may be secured or unsecured.

(h) *Collateral Trust Bonds.* A collateral trust bond is one which is secured by collateral—usually stocks and bonds of other corporations owned by the issuing corporation. These are deposited with a trustee under an agreement setting forth the conditions of the trust. Such a bond is frequently termed a "debenture." (See § 353.)

(i) *Guaranteed Bonds.* A guaranteed bond is one the payment of which, either as to interest or principal, or both, has been guaranteed by some other corporation. Such a guarantee must be in writing and must either be written on the instrument itself or be attached to it, to be effective.

Under proper conditions such guaranteed bonds are legal and are frequently issued. Thus the bonds of a subsidiary road may be guaranteed by the parent road, or a bond of a component corporation may be guaranteed by the holding company or trust of which it forms a part. (See Form 39.)

(j) *Consolidated, etc. Bonds.* Consolidated bonds, adjustment bonds, reorganization bonds and refunding bonds are used, as their names indicate, in the various consolidations and adjustments common in the combinations or reorganization of railroads and of the larger industrial corporations.

Thus a consolidated bond will be used to retire two or more smaller issues, the new bonds usually being secured upon the properties which previously supported the retired issues.

Refunding bonds are those used to replace or redeem bonds which are maturing. Usually refunding bonds carry a lower rate of interest than the bonds they replace, although if the money conditions are difficult at the time, the interest rate may be the same or even higher. Refunding bonds are sometimes exchanged directly for the old bonds, or otherwise are sold to provide money for the retirement of the maturing bonds.

Adjustment bonds are those used in readjustments or consolidations of existing indebtednesses. Reorganization bonds are those issued when a corporation is in process of reorganization and are usually employed to take up, or as a substitute for other outstanding issues.

(k) *Interest Bonds.* Interest bonds are those issued in payment of interest due on bond issues when cash is not available for the purpose. They preserve the interest from default and thereby prevent foreclosure and the other legal complications of a default.

(1) *Terminal, etc. Bonds.* Terminal bonds are those issued by and secured on the property of a terminal company which is usually subsidiary to the railroad or steamship line using the terminal. Such bonds are usually issued for terminal purchases or improvements. Extension bonds are those issued by a railroad to extend its lines. Equipment bonds are those issued for equipment, usually by a railroad company, though they might be issued in connection with an industrial corporation. Construction bonds, as their name indicates, are those issued to secure money for the purposes of construction.

(m) *Car Trust Bonds.* Car trust or equipment trust bonds or certificates are issued by a trustee who holds for their security equipment purchased or leased by a railroad company. The money realized from the sale of these bonds goes to the manufacturers or vendors of the equipment, or the bonds may be turned over to them direct. The railroad company receives its equipment, subject to the trust agreement, and retires the equipment bonds in such amounts and at such periods as are fixed by the trust agreement. The title to the equipment does not usually vest in the railroad company until all the bonds are redeemed.

Thus in the recent "New York Central Lines Equipment Trust of 1907," amounting to $30,000,000, the vendors of the equipment purchased, or to be purchased, transferred it to a trustee by whom it was leased to the railroad companies concerned, the money realized from the sale of the bonds paying for the equipment and the payments under the lease gradually retiring the bonds or certificates. In this instance the bonds or certificates issued by the trustee were not only secured on the equipment but were also directly guaranteed by the railroad companies concerned. One-fifteenth of the outstanding certificates are to be retired on the first day of November of each year until all are retired.

Bonds and notes of this character are usually issued in series and are redeemable in their serial order as payments are made by the railroad company. When the final payment is made by the railroad company, the deed of trust by which the property is held is released and the equipment becomes the property of the purchasing company.

(n) *Purchase Money Bonds.* Purchase money bonds are those given to secure money for the purchase of the property by which they are secured.

§ 370. Short Term Notes.

A short term note is merely a corporation's promissory note. (See Form 36.) It may be secured or unsecured. If secured, it is usually by the deposit of collateral with a trustee under a trust agreement. The larger issues are generally in coupon form and differ but little from the usual bond, except in their early maturity.

Short term notes are issued when the existing conditions are unfavorable for a long time loan, and usually carry either a larger rate of interest than a bond issue or are sold at a discount that produces the same practical result. Short term notes are usually floated with the expectation that they will either be retired at maturity or will be taken up by a bond issue on more favorable terms than would have been possible at the time the notes were issued.

PART VI.—FORMS.

CHAPTER XXXIII.

SIGNATURES, CHECKS AND RECEIPTS.

(1) SIGNATURES.

The signatures used in the financial operations of a corporation vary as to form and are usually affixed by the treasurer. An informal signature often employed by the treasurer is as follows:

Form 1.—Treasurer's Signature. Informal.

....

JOHN H. WILSON,
Treasurer.

....

This signature should be affixed only when the corporate name appears prominently upon the instrument signed as otherwise it lacks precision. As a rule it is not employed in matters of importance though it frequently appears on checks and receipts, and is almost invariably used when the treasurer affixes his signature to stock certificates. When used within the scope of the treasurer's authority it is in most states binding upon the corporation.

Form 2.—Treasurer's Signature. Formal.

....

JOHN H. WILSON,
Treasurer Farran Hydro-Carbon Co.

....

This signature is no more effective than the informal signature in binding the corporation but is more explicit and leaves no doubt as to the identity of the person signing and the capacity in which he signs. It should be used in all important matters when for any reason the corporate signature is not employed, and in matters of less importance whenever the corporate name does not appear prominently upon the instrument signed.

Form 3.—Corporate Signature.

(*a*) Farrand Hydro-Carbon Co.,	(*b*) Farrand Hydro-Carbon Co.,
By John H. Wilson,	By Henry H. Farrand, President.
Treasurer.	John H. Wilson, Treasurer.

It is not customary, save in corporate endorsements and similar matters, for the treasurer alone to affix the corporate signature. Almost invariably he joins with some other corporate official, usually the president.

The effect of either of the preceding corporate signatures when properly affixed is to bind the corporation and the corporation only. The treasurer's signature will, as stated, when properly employed, usually bind the corporation without involving the treasurer in any personal liability, but not with the same certainty and conclusiveness as does the corporate signature. Thus in some states the treasurer's official signature to a note intended to be a corporate note, has been held to constitute the treasurer a principal and liable for its payment. It is therefore a safe rule for the treasurer to employ the corporate signature in all the corporate affairs unless there is some special reason to the contrary.

Checks, notes and drafts given in payment of amounts due the corporation are usually made out in the corporate name, and when endorsing these for deposit or collection the treasurer uses the corporate signature in the general form shown in Form 3 (a), the prefix "By" being usually omitted.

In cases where the corporate signature is continuously employed in the same form, as on checks, it is—save as to the name of the affixing officer—usually printed, appearing then as in Form 3 (a), except that the name of the signing official is omitted. The instrument is not then effective until the name of the signing official is written in, completing the signature. A rubber stamp is also frequently employed to affix the corporate signature except the names of the affixing officers which are written in just as in the case of the partially printed signatures.

The endorsement of corporate checks is frequently made in its entirety by means of a rubber stamp in the following general form, no writing of any kind being employed:

Form 4.—Corporate Endorsement.

Pay to the Order of the
MERCHANTS' EXCHANGE BANK
Farrand Hydro-Carbon Co.
JOHN H. WILSON, Treasurer.

This endorsement is accepted by the banks and on account of the ease and rapidity with which it may be affixed, is much used. It lacks the self-proving features of the written endorsement, but, as the instrument so stamped comes direct to the bank from the corporation and under conditions which render the improper use of the stamp practically impossible, its employment is not objectionable.

(2) CHECKS.

Corporate checks are usually signed with the corporate signature affixed by the treasurer and are countersigned by some other corporate official. The treasurer's official signature is frequently employed instead of the corporate signature and is not objectionable as any signature for checks agreed upon between the bank and the corporation is effective and sufficient. (See § 221.)

The legal effect of a check is not affected in any way by its general arrangement nor by the introduction of extraneous matter, provided only that the essential features of the check are not disturbed. (See § 217.) In consequence, checks are found in many different forms, varying according to the taste of the parties by whom they are designed, or according to the conditions under which they are employed. All the check forms presented in the present chapter are taken from checks now in use by corporations of national reputation.

Form 5.—(a) **Check. Ordinary Form.**

Farrand Hydro-Carbon Co.,
315 Pearl St., New York.

No. ......
New York, ... 190....
THE SEABOARD NATIONAL BANK,
of the City of New York.
Pay to the
Order of .... $.........
....Dollars.
Farrand Hydro-Carbon Co.,
By ....
Treasurer.

Form 5.—(b) **Check. Ordinary Form.**

Nelscn Car. Co.
Youngstown, Ohio.

THE DOLLAR SAVINGS AND TRUST CO. No......
Youngstown, Ohio, ... 190....
Pay to the
Order of .... $.........
....Dollars.
Countersigned By Nelson Car Co.,
.... By..................
Pres. Sec'y and Treas.

The form last given has the advantage from the bankers' standpoint of bringing number, date and amount at the right hand side of the check, so that in running through a bundle of checks all may be seen at a glance.

From an advertising standpoint the ordinary form of check is sometimes objectionable to the drawer because of the prominence given the name of the drawee bank and the subordination of the drawer's name. To obviate this, the draft form of check is frequently employed. It is entirely effective, can be arranged in very neat and attractive form and undoubtedly does allow the name of the drawer to be displayed to advantage.

Form 6.—Check. Draft Form.

Countersigned ....

President.

New York, ... 190....

FARRAND HYDRO-CARBON CO., No.......
315 Pearl St., New York.

Pay to the
Order of............................ $..........

....Dollars.

To The
Seaboard National Bank,
New York, N. Y.

Farrand Hydro-Carbon Co.,
By ....
Treasurer.

Checks in this general form are frequently arranged with the name of the drawer in the center of the upper part of check. The date then usually comes to the right and the number of the check to the left, either above or below the level of the name according to individual taste.

The use of checks so phrased or arranged as to serve the purpose of both check and receipt is extending. The advantages of the practice are apparent. It obviates the necessity of writing, mailing and preserving a more formal receipt, thereby lessening labor and avoiding expense. Such checks are a convenience to all parties concerned and afford the best possible receipts for payments made by their means.

Receipt checks are seen in many different forms. The following is simple and effective.

Form 7.—Check. Receipt Form. (a) Brief statement.

Harrison Steel Co.,
318 Chestnut St.,
Philadelphia, Pa.

No. 7201.

PHILADELPHIA, PA., 190....

THE NATIONAL SECURITY BANK
of Philadelphia.

Pay to the order of..

....Dollars.

$..........

HARRISON STEEL CO.,
By ....
Treasurei.

This form gives an opportunity for a brief statement of the account on its face and when properly endorsed and passed through the bank becomes an all sufficient receipt for the payment effected by such check. The original check from which the present form is taken was accompanied by a printed notice as follows:

Form 7.—Check. Receipt Form. (b) Notice Accompanying Check.

.... 190....

Gentlemen:—Enclosed herewith please find our check in payment of your account as indicated thereon.

Your endorsement on the check will be a sufficient receipt.

Yours truly,
HARRISON STEEL CO.

Frequently such notices are merely printed slips sent with the check. At times the statement "No receipt necessary" is printed in the body of the check.

The following form allows a more extended statement than is possible on the form of receipt check first presented. The space for statement might have been increased without detriment to the check, or the same space might have been secured on a check of ordinary size, by allowing the statement ruling to extend to the top of the check. This would bring the entire matter of the check itself to the right of the statement, but still leave it reasonable space.

Form 7.—Check. Receipt Form. (c) Extended Statement.

No. 3605. Newark, N. J., ... 190....

UNION TRUST COMPANY

Pay to the
Order of ....

....Dollars.

In Settlement.							
Date		Debit		Credit		Date	
Total							
Discount							
Net							

AMERICAN
MODEL MANUFACTURING
COMPANY

....
President.

....
Treasurer.

Return Check if Incorrect. $.............

The form of receipt check which follows provides for a statement of account on the back of check.

Form 8.—Check. Receipt Form. (a) Face.

Countersigned, ... President.
V.-Pres.

MONARCH MOTOR CAR CO.,
Chicago, Ill.

No. .... 190....

Pay to the
Order of........................... $..........

....Dollars.

In Payment of Account Stated on the Back of This Check.

En'd C. R. ......

To
Seventh National Bank,
Chicago, Ill.

Monarch Motor Car Co.,
....
Treasurer.

The check as presented provides for a countersignature by either the president or vice-president, the signing officer striking out the title which does not belong to him.

The form on the reverse of this check is as follows:

Form 8.—Check. Receipt Form. (b) **Back.**

Endorsement on This Check is sufficient acknowledgment of the following account. If incorrect return to us at once.

Date.	Amount.	Date.	Amount.

No Receipt Necessary.

The so-called voucher checks do not differ in principle from the receipt checks illustrated, being merely an extension of the same idea. They are, however, sometimes carried to such extremes in size and matter as to become a nuisance to the recipient and to the banks through which they pass.

The voucher check which follows is modest in size and not open to objection. It is in use folded so as to give a width of 8¼ inches and a depth of 3 13/16 inches, a reasonable check size. The check proper appears on the first page of the folder thus formed. The statement form is given below.

This statement occupies the entire inner portion of the folder—8¼ x 7⅝ inches. As presented it is shortened materially in order to save space.

On the fourth or outer page of this voucher check is space for an endorsement, headed as follows: "The Endorsement of This Voucher is Sufficient Acknowledgment of the Payment of Account as Within Stated."

Form 9.—Voucher Check. (a) Face.

(Size of Original—8¼ x 7⅝″.)

H. G. WARING COMPANY.

DAYTON, OHIO, ... 190....

Pay to the
Order of .... $..........

.... Dollars.
100

In full payment of account as shown on the reverse side of the Voucher.

To
WINTERS NATIONAL BANK,
Dayton, Ohio.

H. G. WARING COMPANY,
By ....
Treasurer.

Form 9.—Voucher Check. (b) Statement.

VOUCHER CHECK.

No. 1689.

H. G. WARING COMPANY,
Dayton, Ohio.

Favor of............................
Address............................

Audited and Approved
....

If not correct return without alteration or changes.

The voucher check which follows occupies one side only of the sheet, which is folded so as to bring the statement form on one of the outer pages and the check form on the other.

It will be observed that this voucher check is not an order for the payment of money until the receipt which forms part of it is properly signed and dated. This throws on the bank the burden of deciding whether or no the check has been made effective by a proper date and signature. In practice the banks seldom object to a requirement of this kind.

Form 9.—Voucher Check. (c) Check and Statement.

(Size of Original—8½ x 7 inches.)

MICHIGAN IRON AND STEEL MANUFACTURING COMPANY.

Debtor to.............................. Voucher No. 10027

Detroit, Mich., ...

Date	Bill No.	Amount	Freight	Memoranda	Net Amount

FIRST NATIONAL BANK OF NEW YORK.

Pay the above amount, when the receipt below is properly signed and dated.

Cash Disbursement, Recorded Folio No. ......

Examined and found correct: Michigan Iron and Steel Mfg. Co.

....

Assistant Secretary. Treasurer.

Received, ... 190...., of MICHIGAN IRON & STEEL MANUFACTURING CO., ...Dollars, in full for above account.

$.............

READ THIS.—The above receipt MUST be dated and signed by the person, firm or corporation in whose name the voucher is drawn. Any alteration to any part of this Voucher will make it void.

Do not detach this receipt. Deposit in bank same as a check.

The following form of dividend check is that employed by the United States Steel Corporation for the payment of preferred dividends.

Form 10.—Dividend Check. (a) Form of Check.

Preferred Stock Dividend,
No. 25.

UNITED STATES STEEL CORPORATION.

New York, August 30th, 1907. No......

THE AMERICAN EXCHANGE NATIONAL BANK
of New York.

Pay to the Order of

.... $...........

.... DOLLARS
100

Countersigned
Stock Transfer Department
.............Transfer Agent. ....Treasurer.

With the original of this check was sent a printed announcement as follows:

Form 10.—Dividend Check. (b) **Announcement Accompanying Check.**

UNITED STATES STEEL CORPORATION.

New York, Aug. 30th, 1907.

On July 30th, 1907, the Directors declared quarterly dividend No. 25 of one and three-quarters per cent. upon the preferred stock, payable this day to stockholders of record Aug. 7th, 1907.

In accordance with permanent order on file, enclosed please find check for above dividend on the preferred stock standing in your name.

No acknowledgment is necessary.

Kindly advise F. B. Blinn, Assistant Secretary, No. 71 Broadway, New York, of any change in your address, giving your old address as well as the new.

Richard Trimble, Treasurer.

Dividend Check Enclosed, which Please Cash Immediately.

To this announcement was appended a quarterly statement of the earnings and disbursements of the corporation, identical in form with the statement given in § 194 (2) of the present volume.

(3) RECEIPTS.

A common form of corporate receipt in all ordinary matters is as follows:

Form 11.—Corporate Receipt.

Hardiman Realty Co.,
215 Cedar St.,
New York.

$250. New York, January 10, 1908.

Received of John C. Harrison Two Hundred and Fifty Dollars, rental of Third Loft, No. 315 Pearl Street.

Hardiman Realty Co.,
By Henry H. Hardiman,
Treasurer.

There is no reason why all receipts for moneys received by a corporation should not be given in the corporate name, though in practice they are commonly signed by the treasurer.

When this is the case, the name of the corporation should appear prominently on the receipt, so that, in connection with the official signature of the treasurer, it will show conclusively that the payment was received for account of the corporation.

Thus in the following form, the corporate name should be displayed prominently.

Form 12—Treasurer's Receipt.

$524.75. January 10, 1908.

STANDARD STEEL COMPANY,
261-265 Wall St.
New York City.

Received from the Wilford Smelting Corporation, Five Hundred and Twenty-Four 75-100 Dollars in full of account.

H. J. Ashley,
Treasurer.

The majority of the prominent corporations, when dividends are declared, mail dividend checks which, when properly endorsed and deposited, are regarded as all sufficient receipts. If, however, formal receipts are desired, the following form will serve:

Form 13.—Dividend Receipt.

Halsey Furniture Corp.,
515 West 16th St.,
New York.

DIVIDEND RECEIPT.

$30 Philadelphia, Pa.,
January 12, 1908.

Received of the Halsey Furniture Corporation Thirty Dollars the regular semi-annual dividend of three per cent. on the stock of said Corporation standing in my name

John H. Allison.

This receipt is sent out with the dividend check and is signed and returned by the recipient. When payment of dividends is made at the office of the company, or at the office of some specified trust company or bank, the parties receiving payment usually sign the dividend register and no other receipt is necessary.

The treasurer is frequently called upon to give receipts in connection with the sale of stock. When the full amount of a stock subscription is paid in, the stock certificate is usually issued at once, and, if payment is made by check, no other evidence of the payment is necessary though a receipt is sometimes demanded by the purchaser.

When payment of a stock subscription is made in instalments, the subscriber is not entitled to a stock certificate until the final payment is made and in such case receipts for the instalments as they are paid in are essential. Where it can be conveniently employed the usual stock scrip (Form 15) is the best method of evidencing the instalment payments. If, however, the conditions are such as to make its use inadvisable, an instalment receipt or certificate as follows may be given for each payment.

A receipt of this nature should be printed with a stub, from which it is detached when issued, upon which are entered the important details, viz. number, date, amount, number of shares, name of payee and number of instalment.

Form 14.—Instalment Receipt.

No. 524. NEW YORK, January 12, 1908.

KENSINGTON SEEDER COMPANY
275 Liberty St.,
New York City.

INSTALMENT CERTIFICATE

Received of Henry H. Cadbury One Hundred and Twenty Dollars, the third monthly instalment of Ten Dollars per share on his subscription to Twelve Shares of stock of this Company of the par value of One Hundred Dollars each.

$120. HENRY B. WEYMAN,
Treasurer.

When the final payment is made these instalment receipts are usually surrendered, the stock certificate being issued and delivered in exchange.

A convenient form of stock scrip is as follows:

Form 15.—Instalment Certificate or Stock Scrip.

No. 525. 40 Shares.

HARTFORD MACHINE COMPANY.

INSTALMENT CERTIFICATE.

Total Amount of Subscription, $4,000.

Hartford, Conn., January 6, 1908.

This is to certify that Anice H. Marshall, a subscriber for Forty Shares of the capital stock of the Hartford Machine Co. of Hartford, Conn., at its par value of One Hundred Dollars per share, has paid into the treasury of the Company on account of said subscription and in accordance with its terms, Two Thousand Dollars; balance of said subscription to be paid in monthly instalments of Five Hundred Dollars each, payable on the 1st day of each month hereafter.

Upon payment of full amount of said subscription in accordance with its terms and on surrender of this certificate with said payments endorsed, or receipts therefor attached, duly executed certificates for the said Forty Shares of stock will be issued to the order of the said subscriber.

Henry H. Caspar,
Treasurer.

Willard B. Johnson,
President.

As the remaining instalments are paid, they are endorsed upon the back of this instalment certificate. In case it is difficult to endorse the payment on the certificate—as where the subscriber lives in a distant city—the instalment payments may be evidenced by receipts. In such case when the final instalment is paid the instalment certificate and the receipts should all be surrendered in exchange for the properly issued certificate of stock.

An instalment certificate such as shown is printed with a stub from which it is detached when issued and on which are entered at the time of issue the essential data; viz., number of shares, full amount due, payment, name and date. As each subsequent payment is made, it is endorsed on the back of the certificate, the treasurer's signature evidencing each. Payments, as made, should, with their dates, also be entered on the original stub so that the stub always gives a full record of the conditions.

CHAPTER XXXIV.

RESOLUTIONS AND CERTIFICATIONS.

There is no fixed form in which resolutions must appear. The forms which follow are those most commonly employed.

Form 16.—Resolutions for Payment of Bills.

....

(*a*) RESOLVED, That the bill of Shirley and Morgan for $1,575.25 on account of legal services rendered the Company to date, be and hereby is approved and ordered paid.

(*b*) RESOLVED, That the Treasurer be and hereby is authorized and directed to pay the bills rendered in connection with the erection of the Company's new warehouse, as follows: Smith and Williams, $875; Merrick Building Co., $750; Altman Supply Co., $950; Wehrman and Saunders, $325.

....

Such resolutions do not usually go into the details of the payments authorized, merely designating them with sufficient precision to indicate what accounts are intended. Motions are usually employed to authorize payment of routine or small amounts and are frequently employed for more important matters as well. The resolution is more formal and is therefore preferable for important matters.

Form 17.—Resolution Declaring Dividend.

....

RESOLVED, That the regular semi-annual dividend of Four (4%) Per Cent. from surplus profits be and hereby is declared upon the common stock of the Company, payable on the 20th day of January, 1908, to the stockholders of record as shown by the books of the Company on the 10th day of January, 1908, and that the Treasurer of the Company be and hereby is authorized and directed to pay said dividend in accordance with the terms of the present resolution.

This resolution is entered in the minutes of the Company under the date on which it was adopted; hence its own date need not appear in the resolution. In the public notice of dividends the date on which the declaration is made is usually specified. (See Chap. XXXV, "Dividend Notices.")

Form 18.—Resolution Designating Bank. (a) General Form.

....

Resolved, That the Treasurer be and hereby is authorized and directed to open an account for the Company with the Stamford National Bank of New York City, and to deposit therein all funds of the Company coming into his custody; such account to be in the name of the Company and funds deposited therein to be withdrawn only by check signed by the Treasurer and countersigned by the President.

....

This resolution together with any by-law provisions giving the treasurer power to endorse checks, notes, etc. for deposit is submitted to the bank as evidence of the treasurer's authority in the matter. Both resolution and by-laws should be certified by the secretary of the company. (See Form 20.) The secretary's certificate should, in this case, also designate the treasurer by name and certify to his official position as he is not named in the resolution.

If the resolution authorizes the treasurer by name, as in the form which follows, provision should be made for the authorization to pass to his successor in event of the election of some other person as treasurer.

Form. 18.—Resolution Designating Bank. (b) Limited Powers. One Officer.

....

At a meeting of the Board of Directors of the American Textile Company, held at the office of the said Company at 24 Wall Street, in the City of New York, on the 10th day of January, 1908, a quorum being present, it was,—

Resolved, That the Twelfth National Bank of the City of New York be, and the same hereby is designated as the depositary of the funds of the American Textile Company, and that an account be opened in said Bank in the name of said Company, and that George H. Wehrman, the Treasurer of said Company, so long as he shall be treasurer thereof, is hereby authorized to sign or endorse any instrument for or on behalf of said Company, and have the same placed to the credit of said account, and, also, from time to time, to withdraw or transfer by check or draft or other instrument signed by him but countersigned by Henry G. Maxim, President of the said American Textile Company, or any successor president of said Company, any amount or parts thereof which may, from time to time, be to the credit of said account, and

RESOLVED FURTHER, That the respective powers and authority conveyed by this present resolution shall pass to any duly elected and qualified successor treasurer or president of the said American Textile Company without further action of this Board, and as fully and to the same extent as if said successor officers were named herein.

The undersigned, Secretary of the said American Textile Company, does hereby certify that the foregoing Resolution was duly adopted at a meeting of the Board of Directors of said Company, duly and regularly called and constituted on the date above mentioned, and at which a quorum was duly present.

Dated, New York, January 13, 1908.

ALFRED DILWORTH.

(Seal of Corporation.)

....

Under this resolution the election and qualification of a new treasurer or president must be certified to the bank by the secretary of the company. (See Form 23.) When this is done the new officers are entitled to exercise the powers of the foregoing resolution.

Form 18.—Resolution Designating Bank. (c) Full Powers. Two Officers.

....

At a meeting of the Board of Directors of the Anglo-American Trading Corporation duly held at the office of said Company at 75 Broad Street, in the City of New York, on the 14th day of January, 1908.

Present:

William B. McCord,	T. B. McKnight,
Horace S. Maxwell,	Henry Merrick,
James Anderson,	S. Wells Travis,
Harvey Wells,	Charles H. Crosby,

being a quorum of said Board.

On motion of Charles H. Crosby

IT WAS RESOLVED, That the Seaboard National Bank be, and the same hereby is designated as a depositary of the funds of this Company, and that Horace S. Maxwell, the President, and Henry Merrick, the Treasurer, or either of said persons, or any of their successors in office, be and they hereby are each severally authorized from time to time for and on behalf of this Company, to make or sign checks, drafts, notes, obligations, releases, agreements, receipts, acceptances or other instruments; to endorse checks, notes, drafts, money orders or any other instruments for or relating to the payment of money; to accept drafts, to procure loans, discounts or rediscounts or advances with or without security; to create liens upon or make transfers of any property to secure or pay said bank;

to enter into any agreement relating to general or specific transactions with said bank; to do all acts incidental to any of the above matters; and to pay, adjust, compromise or secure any transaction, matter or liability; and to do all acts therein; to pay all sums due or to become due; to accept and receive notices, demands, vouchers, papers and property and execute receipts, acquittances and agreements pertaining to the same and generally to do all acts and things with reference to any transaction in the name of or on behalf of this Company with the Seaboard National Bank of the City of New York, or in carrying on its business relations therewith, which any of said persons may see fit.

Provided, However, That all checks drawn on the account of said Company with the said bank shall be evidenced by the signatures of both of the persons above authorized.

Resolved Further, That whenever any two of the above named persons or of their successors in office shall make to said bank a written certificate under the seal of this company certifying that any person or persons therein named have been elected a successor or successors in office to any of the parties above named or their successors, said bank is hereby authorized to permit any person so named to act under this resolution in the same manner as if he had been hereinabove named as holder of the office, to which he may be so certified to have been elected.

This Resolution is to continue in force until formally rescinded, and filing due notice thereof with said Seaboard National Bank.

Carried.

This is to Certify that the above Resolution was duly passed at a meeting of the Board of Directors of the Company above named, regularly and duly held at the time and place above stated, and at which the above named persons, being members of said Board, and being a quorum, were duly present.

Hilton H. Westover, Secretary.

Dated, January 14th, 1908.
(Seal of Corporation.)

....

This general form of resolution is that supplied by some of the large banks of New York City and would probably be satisfactory to any of them. The introduction of the names of the directors in the foregoing resolution would hardly seem necessary as the secretary's certificate—"That the foregoing resolution was duly adopted," etc.—covers the ground very fully.

Form 19.—Resolution Ratifying Action of Treasurer.

....

Whereas, The Treasurer of this Company has opened an account in the corporate name with the National Bank of the Republic and is now depositing the moneys of the Company therein, instead of with the Ellis Trust Company, the duly constituted depositary of the funds of the Company; and

Whereas, Such action, though not authorized by this Board, was justified by existing conditions and was dictated by a due regard for the interests of the Company:

Now, Therefore, Be It Resolved, That the action of the Treasurer in depositing the funds of the Company with the National Bank of the Republic as hereinbefore set forth is hereby approved and ratified, and the Treasurer is hereby authorized and directed to continue to deposit the Company's funds in the said National Bank of the Republic until such time as otherwise ordered by action of the Board.

....

Such a resolution relieves the treasurer of all personal liability for his unauthorized act.

Form 20.—Certification of Resolution.

....

CERTIFIED RESOLUTION.

"Resolved, That the President and Treasurer of this Company be hereby authorized and instructed to assign and transfer to the owners in part payment for the Willistown Cotton Mills, entitling certificates as already issued and now in the hands of the Treasurer of this Company for bonds of the Company to the amount of Thirty-Six Thousand, Eight Hundred ($36,800) Dollars."

This is to Certify, That the foregoing is a true and accurate transcript of a resolution, as shown by the minutes, duly passed at a regular meeting of the Board of Directors of the Willistown Cotton Thread Company held in its office at New York City on the 7th day of January, 1908.

In Testimony Whereof, I have hereunto affixed my official signature and the Corporate Seal of said Company this 8th day of January, 1908.

Thomas Markham,
(Corporate Seal.) Secretary.

....

A less formal certification of a resolution is given in Form 18 (c). A notarial acknowledgement and exemplification of the foregoing resolution is given in Form 27.

Form 21.—Certification of Treasurer's Authority.

....

"Resolved, That the Treasurer be and hereby is authorized and empowered to negotiate a loan of Five Thousand ($5,000) Dollars with the Seaman's National Bank of New York City for and on account of this corporation, and to give the corporate note at ninety days from date for the amount of said loan with interest thereon at the rate of Six (6%) Per Cent. per annum, and to discount the same; the net proceeds of said loan to be deposited to the credit of the corporation in the said Seaman's National Bank."

I, James McClelland, Secretary of the John C. Parker Realty Company, do hereby certify that the foregoing resolution is a true and accurate copy of a resolution duly adopted by the Directors of said Company at a regular meeting held in the office of the Company at 415 Montgomery St., Jersey City, N. J., at 4 P. M., on the 13th day of January, 1908, as entered on the minutes of said meeting, and I do hereby further certify that Henry B. Williams is the duly elected Treasurer of the said Company, authorized to negotiate said loan by the terms of said resolution.

IN TESTIMONY WHEREOF, I have hereunto affixed my official signature and the Corporate Seal of the Company in New York, this 14th day of January, 1908.

JAMES MCCLELLAND,
(Corporate Seal.) Secretary.

....

Form 22.—Certification of Extract from Books.

....

I, Harvey Wilson, Secretary of the Mannefred Printing Company of New York City, do hereby certify that the foregoing is a true and correct transcript from the Minute Book of the said Mannefred Printing Company of the proceedings of the regular meeting of the Board of Directors held in the office of the Company on the 14th day of December, 1907.

Witness my official signature and the corporate seal of the said Company this 14th day of January, 1908.

HARVEY WILSON,
(Corporate Seal.) Secretary.

....

The transcript referred to in the foregoing certification should be written on the upper part of the sheet on which the certification appears, or, if the transcript occupies several pages, the certification should appear on the last page. It might be written on a separate sheet and attached to the transcript but is not then so effective.

Form 23.—Certification of Appointment of Officers.

....

I, Emory Harding, Secretary of the Dyett-King Leather Company, do hereby certify that at an election of officers of said corporation held in the office of the Company, No. 167 Dey St., on the 9th day of January, 1908, the Directors of the Company being duly assembled in lawful meeting and a quorum being present, did elect Frederick Meyers, President of said Corporation, and Walter C. Jackson, Treasurer of said Corporation, to serve for the year ensuing and until the due election and qualification of their successors.

IN TESTIMONY WHEREOF, I have hereunto affixed my official signature and the corporate seal of said Company this 15th day of January, 1908.

EMORY HARDING,
(Corporate Seal.) Secretary.

This form of certification might be employed in connection with a designation such as given in Form 18 (b) upon the election of a new president or treasurer, evidencing to the bank the fact of their election and their power to act.

Form 24.—Certification of Treasurer's Report.

....

I, Henry B. Blessing, Secretary of the Broadway Publishing Company, do hereby certify that the foregoing is a true and accurate copy of the report of the Treasurer of said Corporation, John W. Dennison, as presented by him to the Board of Directors at their regular meeting held on the 14th day of January, 1908, and filed by order of said meeting among the records of the Corporation.

IN TESTIMONY WHEREOF, I have hereunto affixed my official signature and the corporate seal of said corporation this 20th day of January, 1908.

HENRY B. BLESSING,
(Corporate Seal.) Secretary.

....

The following auditor's statement and certificate accompanied a balance sheet showing the assets and liabilities of the bank examined. The certificate gives a very good outline of the thorough investigation required before an unqualified auditor's report can be properly made.

Form 25.—Auditor's Certificate. Unqualified.

....

CERTIFICATE.

Gentlemen:

We have audited the books and accounts of the HARTFORD NATIONAL BANK for the year ending January 31, 1907. In detail, our procedure was as follows:

RESOURCES.

Loans and Discounts.—These were verified by actual inspection of the notes on hand. Certificates were obtained from correspondents stating that they held for collection the notes which were not produced. In all cases, letters were sent to makers, or endorsers, requesting confirmation of the genuineness of the notes; and in the case of collateral loans, the collaterals were stated in detail in the letters. Replies have been received from borrowers whose notes make up 95.44 per cent. of the total. The securities pledged as collateral were appraised and the margins were found to be ample in each case.

Stocks and Bonds.—These were verified by inspection. The appraisal of these securities shows that they are carried at a conservative valuation.

Due from Banks.—Statements have been received from correspondents, and all differences have been reconciled.

Cash and Cash Items.—The cash in vault was verified by actual count. The cash items were verified by inspection and were traced to final payment. Certificates were obtained from each member of the Clearing House stating that all the exchanges were paid February 1. Certificates were obtained from reserve agents stating the balances they held, and all differences were reconciled.

All Other Resources.—All items appearing under resources in the accompanying statement, and not specially mentioned above, were verified and found to represent real assets.

LIABILITIES.

Surplus and Undivided Profits.—The earnings for the year ending January 31, 1907, were analysed and found to be correct.

Due to Banks.—Statements of account were sent to correspondents, and certificates obtained stating that the balances were correct.

Deposits.—As many pass-books as possible were balanced. Requests for a confirmation of their balances were mailed to those depositors who did not send in their pass-books. Certificates stating the balances were correct, have been received from individual depositors whose balances compose 92.56 per cent. of the total.

All Other Liabilities.—All items appearing under liabilities in the accompanying statement which are not specially mentioned above were verified and found to be correctly stated; and

We Certify that the accompanying statement shows the true condition of the Hartford National Bank at the close of business January 31, 1907.

Bentley & Laird,
Public Accountants.

Form 26.—Treasurer's Affidavit to Financial Statement.

State of New York, }
County of New York, } *ss.:*

Personally appeared before me this 16th day of January, 1908, Albert Robinson, who being first duly sworn, deposes and says that he is the Treasurer of the Bardwell Hardwood Company; that he has full charge and control of all the books and accounts of said Company; that the above and foregoing statement is taken from said books and accounts; that it is a true and accurate transcript therefrom, and that to the best of his knowledge and belief it is a just and correct presentation of the financial condiion of said Company on this date.

Albert Robinson,
Treasurer.

Sworn to and subscribed before me
the day and year aforesaid.
John Miles,
Notary Public for
New York County.

{ Notarial }
{ Seal }

Form 27.—Notarial Acknowledgement and Exemplification.

State of New York,
County of New York, } *ss.:*

Personally appeared before me this 8th day of January, 1908, Thomas Martin, to me well known, and acknowledged that he signed the foregoing certified resolution and affixed the seal of the Willistown Cotton Thread Company thereto as Secretary of the said Company for the purposes therein set forth, and I have personally examined the Minutes of said Company under said date of January 8th, 1908, and certify that the foregoing resolution is correctly transcribed therefrom.

Maurice Mann,
Notary Public for the State
and County of New York.
No. 000.

{ Notarial Seal }

Term expires December 1st, 1908.

This acknowledgement and exemplification refers to the resolution given in Form 20, and in the original appeared upon the same sheet as did the resolution and its certification by the secretary.

CHAPTER XXXV.

DIVIDEND NOTICES.

As a rule, when dividends are paid by the larger corporations, checks are mailed to the stockholders for the respective amounts due them. In such case notice of the declared dividend is usually given by publication alone, this notice in connection with the dividend check (See Form 10) being considered all sufficient.

If, however, dividends are paid at the office of the treasurer or at some bank or trust company acting for the company, and the stockholders are required to call or send for the dividends due them, a publication notice may not in itself be sufficient, and notice by mail should also be sent. (See § 251.) The notices of the present chapter are in publication form but any of them may by slight changes, as noted later, be brought into proper form for mailing notices.

Form 28.—Common Forms of Dividend Notices.

(1) *Southern Pacific Company.*

....

(*a*) Common.

SOUTHERN PACIFIC COMPANY.
DIVIDEND NO. 5.

A Quarterly Dividend of ONE DOLLAR AND FIFTY CENTS per share, being the fifth dividend of the Common Capital Stock of this Company, has been declared payable January 2, 1908, to the bearers of Dividend Warrants No. 5, annexed to certificates representing such stock, upon presentation and surrender of such warrants to the undersigned Treasurer at the office of the Company, 120 Broadway, New York.

A. K. Van Deventer, Treasurer.

New York, November 14, 1907.

(*b*) Preferred.

SOUTHERN PACIFIC COMPANY,
120 Broadway, New York, November 14, 1907.
DIVIDEND NO. 7.

A dividend of THREE AND A HALF PER CENT. ($3.50 per share) was this day declared on the Preferred Stock of the Southern Pacific Company, payable on demand on and after the 15th day of January, 1908, to the stockholders of record at 3 o'clock P. M. on Tuesday, December 31, 1907. The stock transfer books will be closed at 3 o'clock P. M. Tuesday, December 31, 1907, and will be reopened on January 15th, 1908. Stockholders who have not already done so are requested to file mailing orders for dividends with the undersigned, from whom blank orders can be had on application.

A. K. VAN DEVENTER, Treasurer.

....

The following notices are verified by both treasurer and secretary.

(2) *American Car & Foundry Company.*

....

(*a*) Common.

AMERICAN CAR & FOUNDRY COMPANY.
NEW YORK, December 6, 1907.
COM. CAPITAL STOCK, DIVIDEND NO. 21.

The Board of Directors has this day declared a dividend of One Per Cent. (1%) on the Common Capital Stock of the Company, payable January 1, 1908, to stockholders of record at the close of business December 11, 1907. Transfer books will close December 11, 1907, and reopen January 2, 1908.

Checks will be mailed by the Guaranty Trust Company of New York.

S. S. DELANO, Treasurer.

WM. M. HAGER, Secretary.

(*b*) Preferred.

AMERICAN CAR & FOUNDRY COMPANY.
NEW YORK, December 6, 1907.
PREF. CAPITAL STOCK, DIVIDEND NO. 35.

The Board of Directors has this day declared a dividend of One and Three-quarters Per Cent. (1¾%) on the Preferred Capital Stock of the Company, payable January 1, 1908, to stockholders of record at the close of business December 11, 1907. Transfer books will close December 11, 1907, and reopen January 2, 1908.

Checks will be mailed by the Guaranty Trust Company of New York.

S. S. DELANO, Treasurer.

WM. M. HAGER, Secretary.

....

(3) *American Smelting & Refining Company.*

....

(*a*) Common.

Office of
AMERICAN SMELTING & REFINING COMPANY,
No. 71 Broadway, N. Y. City, Dec. 4, 1907.

QUARTERLY COM. STOCK DIVIDEND NO. 17.

The Directors of the American Smelting & Refining Company have this day declared a Dividend of TWO PER CENT. (2%) on the Common Capital Stock of the Company, payable January 15, 1908, to stockholders of record, December 27th, 1907. The Books of the Company for the transfer of common stock wil be closed at 3 o'clock P. M. December 27th, 1907, and will be reopened January 2, 1908.

W. E. Merriss, Secretary.

(*b*) Preferred.

Office of
AMERICAN SMELTING & REFINING COMPANY,
No. 71 Broadway, N. Y. City, Dec. 4, 1907.

QUARTERLY PFD. STOCK DIVIDEND NO. 34.

The Directors of the American Smelting & Refining Company have this day declared a Dividend of ONE AND THREE-QUARTERS PER CENT. (1¾%) on the Preferred Capital Stock of the Company, payable January 2, 1908, to stockholders of record, at three o'clock P. M. December 13, 1907. The Books of the Company for the transfer of the Preferred Stock will be closed at three o'clock P. M. December 13, 1907, and will be reopened December 18, 1907.

W. E. Merriss, Secretary.

....

The following notice is brief but all-sufficient.

(4) *The Mackay Companies. Common and Preferred.*

....

THE MACKAY COMPANIES.

The regular quarterly dividend of ONE PER CENT. on the preferred shares and the regular quarterly dividend of ONE PER CENT. on the common shares in THE MACKAY COMPANIES will be paid January 2d, 1908, to shareholders of record as they appear at the close of business December 14th, 1907.

The transfer books will be closed for four days only, December 15, 16, 17 and 18, 1907.

Edward C. Platt, Treasurer.

Dated November 27th, 1907.

....

(5) *Union Pacific Railroad Company.*

UNION PACIFIC RAILROAD CO.
A Quarterly Dividend of
$2.50 Per Share on the Common Stock

of this Company has been declared, payable at the Treasurer's Office, 120 Broadway, New York, N. Y., on January 2, 1908, to stockholders of record at 12 M. on Saturday, November 30, 1907.

The stock transfer books will be closed at 12 M. on Saturday, November 30, 1907, and will be reopened at 10 A. M. on Wednesday, December 18, 1907.

Stockholders who have not already done so are requested to promptly file mailing orders for dividends with the undersigned, from whom blank orders can be had on application.

Frederic V. S. Crosby, Treasurer.

(6) *International Nickel Company.*

INTERNATIONAL NICKEL COMPANY.

The Board of Directors have declared a dividend of ONE AND ONE-HALF PER CENT. on the preferred stock for the quarter year ending December 31, 1907, payable on Feb. 1, 1908, to holders of record at the close of business on January 10, 1908. The preferred stock transfer books will be closed at 3 P. M. Jan. 10, 1908, and remain closed until 10 A. M. Feb. 3, 1908.

James L. Ashley, Treasurer.

New York, Dec. 17, 1907.

The foregoing dividend notice of the International Nickel Company may be taken to illustrate the changes necessary to adapt a publication notice for mailing purposes. This would, as a mailing notice, appear as follows:

INTERNATIONAL NICKEL COMPANY,
43 Exchange Place, New York.

New York, December 17, 1907.

Dear Sir:—You are hereby notified that the Board of Directors has declared a dividend of ONE AND ONE-HALF PER CENT. on the preferred stock, etc., etc.

If the stockholders are to call at the office of the company to receive payment of their dividends this fact should be added to the notice, but otherwise its subject matter would be exactly as given in the published form.

Form 29.—Special Forms.

(1) *Extra Dividend.*

MERGENTHALER LINOTYPE COMPANY.

New York, December 10, 1907.

At a meeting of the Board of Directors, held this day, a regular quarterly dividend of 2½ Per Cent. and an extra dividend of 5 Per Cent. on the capital stock of this Company now outstanding (109,900 shares) were declared, payable on and after December 31, 1907, to the stockholders of record on Saturday, December 14, 1907, at one o'clock P. M.

The transfer books will close on Saturday, December 14, 1907, at one o'clock P. M., and reopen on Thursday, January 2, 1908, at ten o'clock A. M.

Fred'k J. Warburton,
Treasurer.

(2) *Transfer Books Not Closed.*

(*a*) INTERNATIONAL PAPER COMPANY.

A quarterly dividend of ONE AND ONE-HALF PER CENT. on the Preferred Stock has been declared, payable January 15th, 1908, to preferred stockholders of record at close of business December 31st, 1907. Transfer books will remain open. Checks mailed.

E. W. Hyde, Secretary.

(*b*) THE BALTIMORE & OHIO RAILROAD CO.

Office of the Secretary.
Baltimore, Md., January 9, 1908.

The Board of Directors this day declared from the net earnings of the Company for the six months ended December 31, 1907, a dividend of Two (2) Per Cent. on the Preferred Stock of the Company, to be paid March 2, 1908, to the stockholders of record at the close of business on February 1, 1908.

The Board also declared from the surplus earnings of the Company a dividend of Three (3) Per Cent. on the Common Stock of the Company, payable March 2, 1908, to the stockholders of record at the close of business on February 1, 1908.

The transfer books will not close.

C. W. Woolford, Secretary.

(3) *Stock Dividend.*

THE WESTERN UNION TELEGRAPH COMPANY.

New York, Dec. 11th, 1907.

The Board of Directors of this Company have ordered that in lieu of the usual cash dividend for the quarter ending December 31st, 1907, a stock dividend equal to ONE AND ONE-QUARTER PER CENT. of the stock held by each stockholder at the close of the transfer books on December 20th, instant, be issued to such stockholders on and after January 15th, 1908. For the purpose of such stock dividend the transfer books will be closed at three o'clock on the afternoon of the 20th day of December, instant, and be re-opened on the morning of the 2d day of January, 1908 A. R. Brewer, Secretary.

....

Form 30.—Notices of Interest Payments.

(1) *Bethlehem Steel Company.*

....

To the Holders of the
FIRST EXTENSION MORTGAGE BONDS AND
SERIAL NOTES
of the
BETHLEHEM STEEL COMPANY.

Coupons maturing January 1st, 1908, of the Bethlehem Steel Company First Extension Mortgage Bonds and Six Per Cent. Serial Notes, issue of July 1st, 1907, will be paid on and after December 20th on presentation and surrender, at the office of Messrs. Harvey Fisk & Sons, 62 Cedar Street, New York City, of the said coupons.

By order. B. H. Jones, Treasurer.

....

(2) *Pennsylvania Company.*

....

PENNSYLVANIA COMPANY.
FOUR AND ONE-HALF PER CENT. LOAN.

Interest due January 1st, 1908, on bonds of this loan will be paid at the National City Bank of New York. Transfer books close December 20th, 1907.

T. H. B. McKnight, Treasurer.

....

CHAPTER XXXVI.

BONDS OF INDEMNITY.

A bond of indemnity should state its conditions clearly and must be executed under seal. The forms of the present chapter follow those generally employed.

Form 31.—Treasurer's Bond. Personal.

TREASURER'S BOND.

KNOW ALL MEN BY THESE PRESENTS, That we, Reginald F. Marshall, of New York City, as principal, and Harry B. Withers and John H. Ellison, also of New York City, as sureties, are held and firmly bound unto the Sterling Manufacturing Company, a corporation duly organized under the laws of the State of New York, in the sum of Fifteen Thousand ($15,000) Dollars, to the payment of which to the said corporation, its successors or assigns, we do by these presents jointly and severally bind ourselves, our heirs, executors and administrators.

Signed and sealed this 15th day of January, 1908.

The condition of the above obligation is that:

WHEREAS, The said Reginald F. Marshall has been elected Treasurer of the said Sterling Manufacturing Company for the period of one year from the 10th day of January, 1908, and may hereafter be re-elected to, or continue in such office for a further period:

NOW, THEREFORE, If the said Reginald F. Marshall shall hereafter in all respects fully, faithfully and honestly perform and discharge the duties of said office so long as he shall continue therein, both during the term for which he has been elected and during such further time as he may continue therein, whether by re-election or otherwise, and shall, when properly so required, fully and faithfully account to the said corporation, its successors or asigns, for all moneys, goods and properties whatsoever for or with which the said Reginald F. Marshall may in anywise be accountable or beholden to the said corporation, and if at the expiration of his term of, or continuance in office, or prior thereto in event of his death, resignation or removal from office, all books, papers, vouchers, money and other property of whatever kind placed in his custody as treasurer of the said corporation, shall be forthwith restored to the said corporation, its successors or assigns, then this obligation shall be void, but otherwise to remain in full force and effect.

REGINALD F. MARSHALL. (L. S.)
HARRY B. WITHERS. (L. S.)
JOHN H. ELLISON. (L. S.)

Signed, sealed and delivered
in the presence of
HAROLD F. WRIGHT,
SAMUEL D. FOSTER.

The liability of this bond is unrestricted, extending to any and all losses the corporation may sustain through the active misdeeds, the omissions or the failures of the treasurer. The terms of a personal bond are, on occasion, modified but they are almost invariably characterized by the stringency of their conditions. For the treasurer and his friends who are to sign the bond, to question its terms would seem to cast doubt upon either the integrity or the ability of the treasurer. It is therefore but seldom that active objection arises to the terms of a personal bond.

When, however, a surety company enters the bonding field, the conditions are entirely different. No personal reasons intervene and the guarantees are reduced to the lowest possible terms. Accordingly a striking difference will be noticed between the sweeping and unreserved liability of the personal bond just given and the cautious circumspection of the surety company bond which follows. This latter, as given, covers nothing save losses arising through the personal dishonesty of the employee amounting to "larceny or embezzlement."

Form 32.—Treasurer's Bond. Surety Company*

....

Know All Men By These Presents, That we ....(hereinafter called the Employe), as Principal, and the NATIONAL SURETY COMPANY, a New York corporation (hereinafter called the Company) as Surety, are held and firmly bound unto .... (hereinafter called the Employer) in the penal sum of............................Dollars, good and lawful money of the United States, for the payment of which amount we do bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

Dated this ....day of ....190....

Whereas, The Employer has appointed the Employe to the office or position of.................... in the service of .... and the Employer requires and may require security in a stated amount as indemnity against loss which the Employe may sustain by or through the personal dishonesty, amounting to larceny or embezzlement ,of the Employe, in the performance of his duties in the position to which he has been or may be appointed by the Employer;

Now, Therefore, For and in consideration of a premium, computed at an agreed rate, the Company hereby covenants and agrees to and with the Employer, that it will, subject to the conditions and provisions herein

* Secured through the courtesy of the National Surety Company of New York City.

contained, which shall be conditions precedent to the right of the Employer to recover under this Bond, at the expiration of three months next after due and satisfactory proof of the loss herein mentioned shall have been furnished the Company, make good and reimburse to the Employer any and all direct loss of money, securities, or other personal property, belonging to the Employer, or in its possession and for which it is legally liable, sustained by the Employer, by or through the personal dishonesty, amounting to larceny or embezzlement, of the Employe, and for which the Employe shall be legally liable to the Employer, occurring at any time during the term beginning the .... day of .... 190.... and prior to the .... day of .... 190...., which said loss shall be discovered during such term or within six (6) months after the last day of such term, and within six (6) months after the Employe's death or his dismissal or retirement from the Employer's service happening during the term aforesaid, and within six (6) months after the termination of this obligation by the Company. Provided, however, the Company's liability on account of the Employe shall in no case exceed the amount for which the Company shall become surety hereunder.

This Bond is executed by the Company upon the following express conditions:

(In order to save space, an abstract only of the conditions of this bond are presented.)

(1) Bond not effective until signed by the Employe and ceases on payment of any loss.

(2) Employer to immediately notify Company, under penalty of failure of bond, of any information coming to his notice tending to show that Employe is unreliable, deceitful, dishonest or unworthy of confidence, or that he is intemperate, gambles or indulges in other dissipation; and if at any time such information is sufficient to establish the fact, Company is not liable thereafter for the misdeeds of Employe.

(3) If present bond is a renewal, liability under preceding bond ceases six months from the renewal date and—if there is any difference in amount between the original bond and the renewal—the total of all losses collected shall not exceed the amount of the larger bond, the intent being that but one guarantee shall exist at any one time.

(4) Any previous default of Employe known to Employer shall void bond.

(5) If Employe resigns, is discharged or ceases to act, Company is not liable for his acts thereafter.

(6) Company is not liable for any existing debt or shortage of Employe, or for funds or property used to make up same.

(7) Employer must give Company immediate written notice on discovery of any loss and must within ninety days thereafter file written claim and proof of loss; failure shall release Company.

(8) If any written statements of Employer concerning Employe are untrue in any particular, Company is released.

(9) Any change of business or relations of Employer and Employe must be notified in writing to and be consented to in writing by the Company, or bond is void, and in case of default Employer shall on request give information and assistance (not pecuniary) assisting the Company in the capture and prosecution of Employe and reimbursement of Company.

(10) Employe agrees to pay Company any loss, damage or expense incurred by the Company herein.

(11) Company not liable hereunder for accident, mistake, negligence, error, breach of contract or for anything save personal dishonesty amounting to larceny or embezzlement of Employe.

(12) If Employer holds other security or otherwise recovers losses sustained through Employe, Company shall pay proportionately less.

(13) Company may terminate bond at any time by written notice to Employer, unearned premium—unless some loss has been already incurred—to be repaid.

(14) No action at law to be had on bond unless commenced within six months after claim is made.

(15) Receipt or retention of bond or making claim for any loss thereunder binds Employer to all the terms hereof; Employer is also required to make frequent audits and examinations and take and use all reasonable precautions against loss.

(16) Premium due must be paid in thirty days or bond is void.

(17) "Employer" means any officer, manager or auditor of Employer having power to supervise and examine books, audit accounts or examine cash or securities.

(18) If Employe is acting jointly for some other person or corporation, joint audits of his accounts shall be made.

(19) Bond may be renewed from year to year.

(20) No condition herein shall be waived by Company unless in writing over the signature of President, Vice-President or Resident Vice-President of said Company, with its duly attested seal affixed.

In Witness Whereof, The Employe has hereunto set his hand and seal and the Company has caused this Bond to be signed by its officers proper for the purpose, and its seal to be hereunto affixed on the date above written.

....
(Employe.)

Signed, sealed and delivered by the
Employe in the presence of:

....

NATIONAL SURETY COMPANY,
By

....
Resident Vice-President.

Attest:

....
Resident Assistant Secretary.

....

Form 33.—Indemnity Bond. Lost Stock Certificate.

....

INDEMNITY BOND.

Know All Men By These Presents, That we, Frank H. Stafford, of New York City, as principal, and Henry W. Bronson and James H. Wells, both also of New York City, as sureties, are held and firmly bound unto the Sterling Manufacturing Company, a corporation duly organized under the laws of the State of New York, in the sum of Ten Thousand ($10,000) Dollars, to the payment of which to the said corporation, its successors or assigns, we do by these presents jointly and severally bind ourselves, our heirs, executors and administrators.

Signed and sealed this 18th day of January, 1908.

The condition of the foregoing obligation is that:

Whereas, The said Frank H. Stafford, the owner of record, as shown by the stock book of the corporation, of Seventy-Five (75) Shares, each of the par value of One Hundred ($100) Dollars, of the capital common stock of the said Sterling Manufacturing Company, the ownership of said stock being further evidenced by certificate No. 275, issued in the name of said Frank H. Stafford on the 15th day of June, 1906; and

WHEREAS, The said Frank H. Stafford has made application to the Board of Directors of the Sterling Manufacturing Company for the issue in his name of a new certificate for the said Seventy-Five (75) Shares of stock, alleging that the original certificate No. 275 is lost, stolen or destroyed and that its present whereabouts and condition are unknown to him; and

WHEREAS, By due and formal resolution of the said Board of Directors a new certificate for said Seventy-Five (75) Shares of the stock of the Sterling Manufacturing Company was this day issued to the said Frank H. Stafford:

NOW, THEREFORE, If the said Frank H. Stafford, his heirs, executors and administrators, or any of them, do and shall at all times hereafter, save, defend and indemnify the said Sterling Manufacturing Company, its legal successors or assigns, of, from and against all demands, claims or causes of action arising from or on account of said certificate No. 275 for Seventy-Five (75) Shares of the capital stock of said Company, and of and from all costs, damages and expenses that shall or may arise therefrom, and shall also deliver or cause to be delivered up to the said Sterling Manufacturing Company for cancellation the said missing certificate No. 275 whenever and so soon as the same shall be found or recovered or come into his possession, then this obligation shall be void; otherwise to remain in full force and effect.

FRANK H. STAFFORD. (L. S.)
HENRY W. BRONSON. (L. S.)
JAMES H. WELLS. (L. S.)

Signed, sealed and delivered
in the presence of
HENRY F. CARROLL.
ANNA B. WILSON.

CHAPTER XXXVII.

CORPORATE SECURITIES.

Form 34.—Preferred Stock. (U. S. Steel Corporation.)

....

SEVEN PER CENT. CUMULATIVE PREFERRED STOCK.

Number Shares

Incorporated under the Laws of the State of New Jersey.

UNITED STATES STEEL CORPORATION.

This is to Certify that ....
is the owner of ....fully paid and non-assessable shares of the par value of one hundred dollars each, in the PREFERRED CAPITAL STOCK of United States Steel Corporation, transferable only in person or by attorney upon the books of said Corporation, upon surrender of this certificate. The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the Corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividend on the common stock shall be paid or set apart; so that, if in any year dividends amounting to 7 per cent. shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock. Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits. In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the Corporation, the holders of the preferred stock shall be entitled to be paid in full with the par amount of their shares and the unpaid dividends accrued thereon, before any amount shall be paid to the holders of the common stock; and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares. The preferred stock and the common stock may be increased as provided in the Certificate of Incorporation. This certificate is not valid without the signatures of the Transfer Agent and the Registrar of Transfers.

Witness the signature of the President or of a Vice-President, and of the Treasurer or of an Assistant Treasurer, of said Corporation.

....
Vice-President.

....
Asst. Treasurer.

SHARES $100 EACH.

....

On the certificate of preferred stock which appears above a space is left at left and right for the respective signatures of the registrar and the transfer agent. On the back of the certificate appears the ordinary form of stock endorsement, as follows:

Form 35.—Stock Endorsement.

....

For Value Received..................hereby sell, assign and transfer unto .... Shares of the Capital Stock represented by the within Certificate and do hereby irrevocably constitute and appoint ....
....Attorney to transfer the said Stock on the books of the within named Corporation with full power of substitution in the premises.

Dated......................19......

....
In the presence of
....

....

When stock is purchased by, donated to or otherwise acquired by a corporation, such stock becomes treasury stock (See §§ 162, 186, 336) and must be assigned and transferred either to the treasurer, to a trustee for the corporation or to the corporation itself. If it were not so transferred, it would remain on the books of the corporation in the names of the former holders and they would technically be entitled to exercise the rights of stockholders.

If such stock is assigned to the treasurer, it should not be in his name, as "John Wilson, Treasurer," but in his official title, thus "Treasurer of the Farrand Hydro-Carbon Company." If assigned to the treasurer by name, trouble may arise as to its transfer at some later date if a new treasurer has succeeded to the office.

There is no objection to stock being assigned directly to the company by name. In such event, in case of sale of the stock, the transfer is signed with the formal corporate signature affixed by either the president or the treasurer, as authorized by the directors. If the stock is held by a trustee, it should be assigned to him by name, as "Henry Johnson, Trustee," the agreement with the trustee fixing the terms upon which such stock is held.

When certificates representing treasury stock are received, they are cancelled and the transfer of the stock is entered upon the books. It is not, however, essential that new certificates be issued to the treasurer, trustee or corporation, as the case may be. Their right to the stock is sufficiently evidenced by the stock book alone and certificates need not be issued to them unless desired.

If certificates are not issued for treasury stock while in possession of the company, the transfer form of the transfer book will be signed, when such stock is sold, with the name in which the stock was entered on the stock books, or if a transfer book is not employed, a formal order filed with the secretary is sufficient authority for his issuance of the stock in the indicated name.

Form 36.—Short Term Note. (a) Form of Note.

....

No........ Series........ $........

UNITED STATES OF AMERICA.
COMMONWEALTH OF PENNSYLVANIA.
PENNSYLVANIA COMPANY.

Four and one-half per cent. Collateral Improvement Note.
Due November 1st, 1907. Total Issue, $50,000,000.

Secured by Deposit of Fifty-eight Million Dollars Par Value of Railroad Stocks as Collateral and by the Guaranty of the Pennsylvania Railroad Company.

The Pennsylvania Company, for value received, hereby promises to pay to the bearer hereof ....

in gold coin of the United States of America, or of equal to the present standard of weight and fineness, on the first day of November, 1907, at either of its Agencies, the office of The Pennsylvania Railroad Company, in the City of New York, or the Office of the said Company in Philadelphia, and to pay interest thereon from the first day of May, 1906, at the rate of four and one-half per cent. per annum at either of said agencies in like gold coin semi-annually on the first day of November and the first day of May in each year, upon presentation and surrender of the annexed interest coupons as they shall respectively mature. Both the principal and interest of this collateral note are payable without deduction for any tax or taxes which the Pennsylvania Company may be required to pay thereon, or to retain therefrom under any present or future law of the United States or of the Commonwealth of Pennsylvania.

This note is one of the series of coupon Collateral Improvement Notes aggregating fifty million dollars, face value of principal, known as the "Four and One-half Per Cent. Collateral Improvement Notes" of the Pennsylvania Company, issued and to be issued under and equally secured by a Trust Agreement dated the first day of May, 1906, between the Pennsylvania Company, The Pennsylvania Railroad Company, and the Fidelity Trust Company, of Philadelphia, as Trustee.

For a description of the property pledged, the nature and extent of the security, the rights of the holders of said Collateral Improvement Notes, and the terms and conditions upon which the same are issued and secured, reference is hereby made to the said Trust Agreement.

This note shall not be valid or become obligatory for any purpose until it shall have been authenticated by the certificate of the said Trustee endorsed thereon.

IN WITNESS WHEREOF, The Pennsylvania Company has caused this note to be signed by its President or one of its Vice-Presidents and its corporate seal to be hereunto affixed, and to be attested by its Secretary or an Assistant Secretary this first day of May, 1906, and the annexed coupons to be executed with the engraved fac-simile signature of its Treasurer.

Pennsylvania Company,
By
President.

SEAL.
Attest:
Secretary.

....

The foregoing short term note is practically in the form of a collateral trust bond, differing only in the short period for which it runs. Coupons are attached to represent interest payments and the notes are secured by collateral deposited with the trustee under a trust agreement.

The coupon attached to the foregoing note is in the ordinary form and is as follows:

Form 36.—Short Term Note. (b) Coupon.

....

PENNSYLVANIA COMPANY

will pay to the bearer on the first day of.......................... at either of its Agencies, the Office of The Pennsylvania Railroad Company in New York, or the Office of the said Company in Philadelphia, ... in gold coin of the United States of America, being six months' interest then due on its Four and One-half Per Cent. Collateral Improvement Note, No. .... Series..........................

T. H. B. McKnight,
Treasurer.

....

Form 37.—Convertible Bond. Coupon Form.

....

UNITED STATES OF AMERICA.
Commonwealth of Pennsylvania.

No. .... $ ....

THE PENNSYLVANIA RAILROAD COMPANY

Ten-Year Three and One-Half Per Cent. Gold Convertible Bond of 1905.

For value received, The Pennsylvania Railroad Company promises to pay to bearer, or, if registered, to the registered owner hereof, at its Office in the City of Philadelphia, Pennsylvania, or at its Agency in the City of New York, New York, in accordance with the terms of an Indenture dated October 2d, 1905, between said Railroad Company and the Girard Trust Company, of Philadelphia, Trustee, on October 1st, 1915, the sum of .... dollars in gold coin of the United States of America or of equal to the present standard of weight and fineness, with interest thereon in the meantime at the rate of three and one-half per centum per annum, payable at either the Office or Agency aforesaid, in like gold coin, semi-annually on the First day of the months of June and December in each year (except that two months' interest to December 1st, 1905, shall be payable on the latter date), upon presentation and surrender of the coupons hereto annexed as they severally mature, and without any deduction in respect to principal or interest for any tax or taxes which may be imposed thereon by the laws of the United States of America, or of the Commonwealth of Pennsylvania, which the Railroad Company may be required to deduct therefrom.

This bond is one of a number of bonds, which may be issued in either coupon or registered form, to the aggregate amount of one hundred million dollars. All said bonds are issued under and in pursuance of said Indenture, to all the provisions of which this bond and the rights of the holder, or registered owner, of the same are subject, and to which by the receipt hereof the holder, or registered owner, of this bond assents.

If default shall be made in the payment of any instalment of interest hereon, and such default shall continue for thirty days, the principal of all such bonds may become due and payable in the manner and with the effect provided in said Indenture.

This bond is subject to redemption at par, and accrued interest, at the option of the Railroad Company, on December 1st, 1910, or on any subsequent interest day, on ninety days' notice as provided in said Indenture, and may be converted into the capital stock of the Railroad Company at the rate of seventy-five dollars per share, at the option of the holder, or registered owner, in accordance with the provisions of the said Indenture, at any time after December 1st, 1905, and prior to the maturity hereof, unless called for redemption; but, notwithstanding the same may be so called for redemption, the holder, or registered owner, shall have the right to have the same converted into capital stock at the rate hereinabove named at any time up to thirty days prior to the date named for redemption in said call.

This bond shall pass by delivery, unless registered as to principal in the owner's name upon the books of the Railroad Company, at its Office in the City of Philadelphia, Pennsylvania, or at its Agency in the City of New York, New York, such registration being noted on the bond by the Railroad Company, and, after such registration of ownership duly certified hereon, no transfer shall be valid unless made on said books by the registered owner in person or by his attorney duly authorized, and similarly noted on the bond, but the same may be discharged from registration by being transferred to bearer, and thereupon transferability by delivery shall be restored. This bond may again from time to time be registered or transferred to bearer as before. The registration of this bond shall not affect the negotiability of the coupons by delivery.

All rights of action on this bond and the annexed coupons are vested in said Trustee, and the enforcement thereof is governed by the provisions of said Indenture.

The holder, or registered owner, hereof, may at his option surrender for cancellation this bond with all unmatured coupons hereto attached or appertaining, in exchange for a registered bond without coupons as provided in said Indenture, but no registered bond will be issued of a less denomination than one thousand dollars.

This bond shall not be valid and become obligatory for any purpose until it shall have been authenticated by the certificate of the said Trustee endorsed hereon.

In Witness Whereof, The said Railroad Company has caused this Bond to be signed by its President or one of its Vice-Presidents, or other person duly authorized by its Board of Directors to sign for the President, and its corporate seal to be hereunto affixed duly attested by the signature of its Secretary or an Assistant Secretary, or other person duly authorized by its Board of Directors to attest for the Secretary, this Second day of October, 1905.

The Pennsylvania Railroad Company,
SEAL. By
Attest: President.

Secretary.

....

This bond is discussed in § 369 (d) of the present volume. It will be noted that the bond is issued in both coupon and registered form, and a coupon bond may, if the bearer desires, be registered, or a registered bond may be exchanged for a coupon bond.

Form 38.—Guarantee of Note.

....

For a valuable consideration, The Pennsylvania Railroad Company does hereby guarantee to the holder of the within note the due and punctual payment by the Pennsylvania Company of the interest upon the said note, in gold coin of the United States of America, of or equal to the present standard of weight and fineness, as the same shall from time to time become due, and the payment of the principal of the within note, in like gold coin, when the same shall be or become due, in accordance with the terms of the agreement mentioned in the said note.

In Witness Whereof, The Pennsylvania Railroad Company has caused this guaranty to be signed by its President, or one of its Vice-Presidents, or other person duly authorized by its Board of Directors to sign for the President, and its corporate seal to be hereunto affixed, duly attested by the signature of its Secretary, or an Assistant Secretary, or other person duly authorized by its Board of Directors to attest for the Secretary, this first day of May, 1906.

The Pennsylvania Railroad Company,
SEAL. By
Attest: President.

Secretary.

....

This guarantee applies to the short term note of Form 36 (a). It is unequivocal in its terms, guaranteeing both principal and interest.

Form 39.—Guarantee of Bond.

....

For value received, the Southern Pacific Company unconditionally guarantees to the owner of the within bond the punctual payment of the principal and interest thereof as the same mature, and agrees itself punctually to pay the said principal and interest if default in the payment thereof be made by the Southern Pacific Railroad Company. To the end that the principal and interest of said bond shall be paid without deduction for any tax or taxes which the Southern Pacific Railroad Company may be required to pay thereon or to retain therefrom under any present or future law of the United States or of any State, County or Municipality therein, the Southern Pacific Company hereby agrees to pay any such tax or taxes in so far as the same shall not be paid by the Southern Pacific Railroad Company.

In Witness Whereof, The said Southern Pacific Company has caused these presents to be signed by its President or one of its Vice-Presidents, and its corporate seal to be hereunto affixed and to be attested by its Secretary or an Assistant Secretary as of January 3, 1905.

Southern Pacific Company,
SEAL. By
Attest: Vice-President.

Assistant Secretary.

....

The foregoing guarantee is also very direct and unequivocal in its terms. It differs from the preceding guarantee in the fact that the Southern Pacific Company is not called upon to pay interest unless interest is first defaulted by the Southern Pacific Railroad Company, the corporation by which the bonds are issued.

Form 40.—Coupon Bond. (U. S. Steel Corporation.)

....

UNITED STATES OF AMERICA.
State of New Jersey.
UNITED STATES STEEL CORPORATION.

Ten-Sixty-Year Five Per Cent. Sinking Fund Gold Coupon Bond.

$ .... No. ....

United States Steel Corporation, a corporation created and existing under the laws of the State of New Jersey, and hereinafter termed the "Steel Company," for value received promises to pay, on the first day of April, A. D. 1963, at the office or agency of the Steel Company in the City of New York, to bearer, or if registered, to the registered holder of this bond, ... thousand dollars in gold coin of the United States, of the present standard of weight and fineness, and to pay interest thereon from April 1, 1903, at the rate of five per cent. per annum, such interest to be payable at such office or agency in like gold coin semi-annually on the first day of May and of November in each year (except that the first installment is to be for seven months and the last for five months' interest), but only upon presentation and surrender of the respective coupons for such interest hereto attached as they severally mature. All payments upon this bond, both of principal and interest, shall be made without deduction of any tax or taxes which the Steel Company, its successors or assigns, may be required to pay, deduct or retain therefrom under any present or future law of the United States, or of any State, County, or Municipality therein.

This bond is one of a duly authorized issue of coupon bonds and registered bonds of the Steel Company, the aggregate amount whereof is limited so that there shall never at any one time be outstanding bonds of said issue for an aggregate principal sum exceeding $250,000,000; all of which bonds have been issued, or are to be issued, under and in pursuance of, and are to be secured ratably by, and are subject to, an indenture dated April 1, A. D. 1903, duly executed by the Steel Company to the United States Trust Company of New York, as Trustee, covering, subject to the prior lien of the indenture dated April 1, 1901, executed by the Steel Company to the United States Trust Company of New York, all the stocks, bonds and other property now or at any time hereafter subject to said indenture dated April 1, 1901, and all the stocks, bonds and other property that by the terms of said indenture dated April 1, A. D. 1903, shall be subject to the lien thereof; and hereby reference is made to said indentures with the same effect as if herein fully set forth.

No recourse shall be had for the payment of the principal or interest of this bond against any stockholder, officer or director of the Steel Company, either directly or through the Steel Company, by virtue of any statute or by enforcement of any assessment or otherwise; any and all liability of stockholders, directors and officers of the Steel Company being hereby released.

This bond shall pass by delivery unless registered in the owner's name on the books of the Steel Company at its office or agency in said City of New York, such registry being noted on the bond by the bond registrar of the Steel Company, after which no transfer shall be valid unless made on said books in the manner prescribed in said indenture, and similarly noted on the bond; but the same may be discharged from registry by being transferred in like manner to bearer, after which transferability by delivery shall be restored; but again, from time to time, it may be registered or transferred to bearer as before. Such registration, however, shall not affect the transferability of the coupons for the interest hereon, by delivery merely, and payment to the bearer thereof shall discharge the Steel Company in respect of the interest therein mentioned whether or not the bond shall have been registered.

This bond, with the coupons for all interest installments which shall not have matured, may also, as provided in said indenture, be exchanged for a registered bond without coupons for an equal aggregate principal sum.

Neither this bond nor any coupon for interest thereon shall become or be valid until the bond shall have been authenticated by the certificate endorsed hereon duly signed by the Trustee under said indenture.

This bond is subject to redemption at the pleasure of the Steel Company as provided in said indenture, on any first day of May or any first day of November, after April 1, 1913, by payment of the principal of the bond and the unpaid accrued interest, together with a premium of ten per cent. of such principal. The Steel Company annually will pay the sum of $1,010,000 to the Sinking Fund Trustees under said indenture, which sum is to be applied to the redemption of bonds of said issue, in the manner provided in said indenture.

No action or proceeding at law or in equity shall be instituted or shall be maintainable upon this bond or upon any of the coupons hereof for the enforcement or collection of interest or for maturing the principal thereof by reason of any default in payment of any installment of interest hereon, until after such installment thereof shall have been unpaid and in default for the continuous period of two years, nor except when and as permitted by the terms of said indenture.

In Witness Whereof, Said United States Steel Corporation has caused these presents to be signed by a Vice-President, and its corporate seal to be hereunto affixed, and to be attested by its Secretary or by an Assistant Secretary, and coupons for such interest bearing the engraved fac-simile signature of its Treasurer to be attached hereto, the first day of April, A. D. 1903.

UNITED STATES STEEL CORPORATION,
(Seal) By ....
Attest: Vice-President.
....
Secretary.

....

This bond, as will be noted, may be registered if desired and may again be restored to its first condition of transferability by delivery. Its registration does not, however, affect the coupons which pass by delivery alone and are payable to bearer regardless of whether the bond be registered or transferable by delivery. This would be the case without provision therefor in the bond unless the coupons contained express stipulations to the contrary.

The coupon which follows is attached to the preceding bond. A more common form of coupon is shown under Form 36 (b).

Form 41.—Coupon. (U. S. Steel Corporation.)

....

No. .... $..........

Coupon for $ ...., gold coin of the United States of America, payable to bearer on the first day of .... at the office or agency of the United States Steel Corporation in the City of New York, without deduction for taxes, for .... months' interest due on that day on the $............ Ten-Sixty-Year Five Per Cent. Sinking Fund Gold Bond of United States Steel Corporation, No. .... subject to the terms of said bond, and of the indenture dated April 1, 1903, therein mentioned.

....

Treasurer.

....

Form 42.—Registered Bond. (U. S. Steel Corporation.)

....

UNITED STATES OF AMERICA.

State of New Jersey.

UNITED STATES STEEL CORPORATION.

Registered Ten-Sixty-Year Five Per Cent. Sinking Fund Gold Bond.

$ .... No. ....

United States Steel Corporation, a corporation created and existing under the laws of the State of New Jersey, and hereinafter termed the "Steel Company," for value received, promises to pay to ....or registered assigns, on the first day of April, A. D. 1963, at the office or agency of the Steel Company in the City of New York, the sum of...........................dollars in gold coin of the United States, of the present standard of weight and fineness, and to pay interest thereon from the first day of May or the first day of November, as the case may be, next preceding the date hereof, at the rate of five per cent. per annum, such interest to be payable to the registered holder hereof at such office or agency in like gold coin semi-annually on the first day of May and of November in each year, except that if this bond be dated prior to November 1, 1903, seven months' interest from April 1, 1903, shall be payable November 1, 1903, and that the five months' interest from November 1, 1962, shall be payable April 1, 1963. All payments upon this bond, both of principal and interest, shall be made without deduction of any tax or taxes which the Steel Company, its successors or assigns, may be required to pay, deduct or retain therefrom under any present or future law of the United States, or of any State, County or Municipality therein.

This bond is one of a duly authorized issue, etc.—(Same as similar paragraph in "Coupon Bond," Form 40.)

No recourse shall be had for the payment, etc.—(Same as similar paragraph in "Coupon Bond," Form 40.)

This bond is transferable only in the manner prescribed in said indenture, on the books of the Steel Company at its office or agency in the City of New York, upon surrender and cancellation of this bond; and thereupon a new registered bond will be issued to the transferee in exchange therefor on payment of the charge provided in said indenture.

This bond, also, as provided in said indenture, may be exchanged for a coupon bond or coupon bonds for an equal aggregate principal sum.

This bond shall not become or be valid until authenticated by the certificate endorsed hereon, duly signed by the Trustee under said indenture.

This bond is subject to redemption, etc.—(Same as similar paragraph in "Coupon Bond," Form 40.)

No action or proceeding at law, etc.—(Same as similar paragraph in "Coupon Bond," Form 40, except that phrase "or upon any of the coupons hereof" is omitted.)

In Witness Whereof, said United States Steel Corporation has caused these presents to be signed by a Vice-President, and its corporate seal to be hereunto affixed, and to be attested by its Secretary or by an Assistant Secretary, this ....

UNITED STATES STEEL CORPORATION,

(Seal) By
Attest: Vice-President.

Secretary.

....

The ownership of a coupon bond payable to bearer, as stated, passes by mere delivery. A registered bond passes only by assignment and the assigned bond is then surrendered and a new bond issued to the new owner just as in the case of stock transfers.

The following trustee's certificate appears upon the preceding bonds, both coupon and registered.

Form 43.—Trustee's Certificate.

....

This is to certify that this bond is one of the issue of bonds of United States Steel Corporation mentioned in the indenture dated April 1, 1903, within referred to, executed by United States Steel Corporation to the undersigned as Trustee.

UNITED STATES TRUST COMPANY OF NEW YORK,
By
....

....

The deed of trust which follows is a very good, short form, containing most of the usual clauses. It may be noted that no provision is made for redemption of bonds prior to their maturity. Such right of redemption before maturity is frequently desirable and in such case should be incorporated in the deed of trust. The usual provision either authorizes the purchase of bonds at the market price, not exceeding some stated maximum, or otherwise provides for their redemption at a fixed price—usually five or ten per cent. above par. The bonds to be redeemed are usually in either case selected by lot.

Form 44.—Deed of Trust.

....

DEED OF TRUST.

AN INDENTURE, dated the second day of January, one thousand, nine hundred and eight, between

HARNEY CAR MANUFACTURING COMPANY, a corporation organized and existing under the laws of the State of New Jersey (hereinafter termed the "Car Company"), party of the first part; and

NATIONAL TRUST COMPANY OF NEW YORK, a corporaion created and existing under the laws of the State of New York (hereinafter termed the "Trustee"), party of the second part.

WHEREAS, The Car Company desires to extend and further equip its plant at Carteret, New Jersey, and for that purpose, being thereto duly authorized by resolutions heretofore adopted by its Board of Directors and by its stockholders, has determined to make and to issue its first mortgage, six per cent., ten year, gold bonds, amounting in the aggregate to Five Hundred Thousand ($500,000) Dollars, said bonds to be issued at the option of the Company, in part as coupon bonds payable to bearer and in part as registered bonds without coupons, and in denominations of $500 and $1,000, all of said bonds to bear date February 1st, 1908 and to be payable February 1st, 1918, in gold coin of the United States. of the present standard of weight and fineness, with interest thereon in the meantime at the rate of six per cent. per annum, payable in like gold coin semi-annually on the first days of February and August in each year, said coupon bonds to be exchangeable at the option of the holders for registered bonds without coupons, and said registered bonds without coupons to be exchangeable at the option of the registered owners for coupon bonds, and each bond to bear a distinctive number or designation, and the payment of the principal and interest of said bonds to be secured by a mortgage or deed of trust that shall be a first mortgage on the entire plant of the said Car Company at Carteret, New Jersey, as hereinafter described, said deed of trust to be in substantially the form of this indenture; and

WHEREAS, Each of the coupon bonds is to be substantially of the following tenor,—the number and the principal sum of the bond having been inserted in the respective blanks therefor, and $1,000 bonds being designated by the letter "A" placed before the number of each bond, and $500 bonds by the letter "B" placed before the number of each bond;

(Coupon bond appears here. See Form 40 for general form.)

AND WHEREAS, At the time of the issue thereof, there are to be attached to each of said coupon bonds hereby secured, coupons representing the installments of interest which may become due thereon; and every such coupon is to be substantially of the following tenor,-the sum payable thereon, the number of months' interest in respect of which the same was issued, the amount of the bond and its number, and the engraved fac-simile signature of the Treasurer of the Car Company, having been inserted in the respective blanks therefor:

(Coupon appears here. See Form 41 for general form.)

And Whereas, Each of the registered bonds without coupons is to be substantially of the following tenor,—the number and the principal sum and the date of the bond having been inserted in the respective blanks therefor, and $1,000 bonds being designated by the letter "C" placed before the number of each bond and $500 bonds by the letter "D" placed before the number of each bond;

(Registered bond appears here. See Form 42 for general form.)

And Whereas, On each of said coupon bonds and on each of said registered bonds without coupons there is to be endorsed a certificate of said National Trust Company of New York or its successor appointed hereunder, of the following tenor;

(Trustee's certificate appears here. See Form 43 for general form.)

Now, Therefore, This Indenture Witnesseth: That in order to secure the payment of the principal and the interest of all of said first mortgage, six per cent., ten year, gold bonds of the Car Company at any time issued and outstanding under this indenture, and in consideration of the premises and of the purchase and acceptance of said bonds by the holders thereof, and of the sum of One Dollar to it duly paid by the Trustee, the receipt whereof is hereby acknowledged;

The Car Company, party of the first part hereto, has granted, bargained, sold, aliened, released, conveyed, assigned, transferred and set over, and by these presents does grant, bargain, sell, alien, release, convey, assign, transfer and set over unto the Trustee, party of the second part, and its successor or successors in the trust hereby created, all and singular:

The plant and property now belonging to the Car Company situated in the County of Middlesex and State of New Jersey and more particularly described as follows,—To Wit:

(Specific description of the property conveyed.)

To Have and To Hold the said aforedescribed premises and property, with all buildings, fixtures, articles and property of every kind belonging to or pertaining unto the same, unto the said Trustee, its successors and assigns forever;

But In Trust, Nevertheless, under and subject to the conditions and provisions hereinafter set forth and for the equal proportionate benefit and security of all present and future holders of the bonds and interest obligations issued and to be issued under and secured by this indenture, and for the enforcement of the payment of such bonds and interest obligations when payable, in accordance with the provisions of such bonds and interest obligations and of this indenture, without preference, priority or distinction as to lien or otherwise of any one bond over any other bond, by reason of priority in the issue or negotiation thereof, or by reason of any other cause.

And Hereby It is Further Covenanted and Declared that all such bonds with the coupons for interest thereon are to be issued, certified and delivered and that the aforedescribed property hereby mortgaged and conveyed is to be held by the Trustee upon and subject to the further covenants, conditions, uses and trust hereinafter set forth, namely:

First.—From time to time the bonds to be secured hereunder shall be executed by the Car Company and by it shall be delivered for certification to the Trustee and shall by the Trustee be certified and be delivered as may be directed by resolution of the Board of Directors of the Car Company. A copy of any such resolution certified by the Secretary under the corporate seal, shall be full authority to the Trustee for the certification and delivery of said bonds. The bonds to be executed, certified and delivered pursuant to this provision may be coupon bonds or registered bonds.

Before certifying or delivering any coupon bond hereby secured, the Trustee shall detach therefrom and shall cancel all coupons then matured. Every registered bond shall be dated on the date of the actual certification thereof.

Only such of said bonds as shall bear thereon a certificate substantially in the form hereinbefore recited, duly executed by the Trustee, shall be secured, either as to the principal thereof or as to any interest thereon, or as to any coupon attached thereto, by this indenture or shall be entitled to any lien or benefit hereunder or shall be valid for any purpose.

Second.—Whenever any coupon bond or bonds issued under this indenture, together with all unmatured coupons thereto belonging shall be surrendered for exchange for a registered bond or bonds, the Car Company shall execute and the Trustee shall certify and deliver, in exchange for such coupon bond or bonds, a registered bond or bonds for the like aggregate principal sum. Every registered bond so delivered in exchange for coupon bond or bonds shall bear interest from the date of the last matured coupon of the surrendered bond or bonds.

Whenever any registered bond or bonds issued under this indenture shall be surrendered for exchange for a coupon bond or bonds, the Car Company shall issue and the Trustee shall certify and deliver, in exchange for such registered bond or bonds, a coupon bond or bonds for the like aggregate principal sum, with the coupons maturing on and after the date when the next semi-annual installment of interest would have matured on such surrendered bond or bonds.

Whenever any registered bond or bonds without coupons issued under this indenture shall be surrendered for transfer, accompanied by delivery of a written instrument of transfer in form approved by the Car Company, and duly executed by the registered owner of said bond or bonds, the Car Company shall execute and the Trustee shall certify a new registered bond or bonds for the like aggregate principal sum and shall deliver same to the transferee or transferees, and such new registered bond or bonds shall bear interest from the date of the last semi-annual installment of interest paid on the surrendered bond or bonds.

In every case of such exchange or transfer the Trustee shall forthwith cancel the surrendered bond or bonds and coupons and shall deliver the same to the Car Company.

In case of any exchange of coupon bonds for registered bonds, or registered bonds for coupon bonds, or transfer of registered bonds, the Car Company may at its option require the payment of such sum as may be necessary to meet the expenses connected with such exchange, such sum, however, not to exceed One Dollar for each new coupon bond or registered bond issued upon such exchange or transfer.

Third.—Until default shall be made by the Car Company in the payment of the principal or interest of any of the bonds hereby secured, or in part thereof, or in the performance of any of the covenants, agreements and promises on its part to be kept and performed as herein set forth, the Car Company, its successors and assigns, shall be permitted to possess, operate and enjoy the real and personal property hereby mortgaged with all the appurtenances thereunto belonging, in all respects as fully as if this indenture had not been made.

Fourth.—The Car Company covenants and agrees that duly and punctually it will pay the principal and interest of every bond issued hereunder at the dates and the place and in the manner mentioned in said bonds or in the coupons thereto belonging, according to the true intent and meaning thereof, without deduction of any tax or taxes which the Car Company, its successors or assigns may be required to pay, deduct or retain therefrom under any present or future law of the United States or of any state, county or municipality therein, and that it will not declare any dividend on any shares of its capital stock, preferred or common, while any default shall exist in the payment of the interest on any of the bonds hereby secured.

The interest on coupon bonds shall be payable only upon presentation and surrender of the several coupons for such interest as they respectively mature, and when paid such coupons shall forthwith be cancelled. The interest on registered bonds shall be payable only to the registered owners thereof.

Fifth.—The Car Company further covenants and agrees that it shall and will from time to time pay and discharge, before the same shall fall into arrears, all taxes, water rates, assessments and charges lawfully imposed upon the hereby mortgaged premises and properties or any part thereof, the lien of which might or could be held to be equal or superior to the lien hereof, and will pay and discharge all claims of every kind which may hereafter become a lien upon the premises and properties hereby mortgaged or any part thereof, prior or equal to the lien hereof, so that the priority of this mortgage may be duly preserved; and said Car Company further covenants that it will keep such mortgaged premises and properties in good order and repair and will not create or suffer to be created any mechanics', laborers' or other lien or charge whatsoever upon the mortgaged premises or any part thereof, whereby the lien of this indenture might or could be impaired, until the bonds hereby secured with all interest accrued thereon shall be fully paid and satisfied.

Sixth.—The Car Company covenants and agrees that the buildings, structures and machinery situated upon the premises affected by this mortgage shall be kept insured, in such insurance company or companies authorized to transact business in the State of New Jersey as may be approved by the Trustee, during the entire term of this indenture, to the amount of not less than Two Hundred Thousand ($200,000) Dollars against loss or damage by fire and that the said Car Company shall and will pay all premiums upon all policies for such insurance. All such policies shall be made payable to the Trustee and shall be deposited with it for the benefit and protection of the bondholders should any loss occur from fire during the term of this indenture. Any payments on insurance under such policies received by the Trustee may be applied directly by the Trustee to the repair or replacement of the property damaged or destroyed, or the Trustee may authorize the Car Company to contract for such repairs or replacements and pay part or all of the cost thereof from said insurance moneys.

Seventh.—The Car Company shall create a sinking fund for the redemption of the bonds issued hereunder by payment of the sum of Fifty Thousand ($50,000) Dollars to the Trustee on the first day of February, 1909, and a like amount on each succeeding first day of February thereafter, until all the bonds issued hereunder shall have been redeemed or until the fund so created shall, with interest accrued or to accrue thereon, be sufficient to provide for such redemption.

Eighth.—The Car Company covenants and agrees that this present indenture shall be a first mortgage upon the premises and property affected thereby, that the same shall be duly executed and recorded in the proper office of registry in the County of Middlesex where the said premises are situated, and that the Car Company will execute and deliver all such further deeds, transfers, pledges and assurances as the Trustee shall reasonably require, to better secure the payment, as herein contemplated, of the principal and interest of the bonds issued hereunder.

Ninth.—When and as the interest coupons attached to the bonds hereby secured mature and are paid by the Car Company, or by any person or corporation for it or on its behalf, such paid coupons shall be cancelled, and no purchase or sale of the said coupons or advances or loans upon the same made on behalf of, or for, or at the request of, or with the concurrence of the said Car Company, shall be taken to operate as keeping the said coupons alive or in force under this indenture, as against the holders of the bonds and attached coupons secured hereby.

Tenth.—In case default shall be made in the payment of interest on any of the bonds issued hereunder, and such default shall continue for a period of six months after demand, or in case default shall be made in the performance of any other covenant or condition hereby required to be kept or performed by the Car Company, and if the same shall continue for a period of six months after demand made for such performance, the Trustee may, and, upon the written request of the majority in amount of the holders of the bonds then outstanding, shall by written notice to the Car Company, declare the principal of all the bonds hereby secured then outstanding, to be, and the same shall thereupon become, immediately due and payable.

Eleventh.—In case default shall be made in the payments of the principal or interest of any of the said bonds when the same is due and payable according to the tenor thereof, or if default shall be made in the performance of any other covenant or condition, hereby required to be kept or performed by the Car Company, and if any such default in payment or performance shall continue for a period of six months after demand by the Trustee, then and in every such case the Trustee, or its successors in the Trust, may by its attorneys and agents enter into and upon all and singular the premises hereby conveyed, and each and every part thereof, and operate and conduct the business of the said Car Company in all respects as the said Car Company might do in possession of the same; and may collect and receive all rents, income, revenue and profit to be derived therefrom, and after deducting all proper and necessary outlays and expenses as well as a just compensation for its own services and for the services of such attorneys, agents and assistants as it may, in its discretion, employ for any of the purposes aforesaid, said Trustee shall apply the rest and residue of the moneys received by it *pro rata* to the payment of the interest due upon such of said bonds as shall then be outstanding. In any such case if payment of all interest and any principal due shall be made in full and no suit to foreclose the mortgage shall have been begun or sale been made, the said Trustee shall restore the possession of the premises so entered, to the Car Company subject to all the terms of this indenture and without prejudice to similar entry later in case of similar default.

Twelfth.—In case default shall be made in the payment of the principal or interest of the said bonds, when the same is due and payable according to the tenor thereof, or if default shall be made in the performance of any other covenant or condition hereby required to be kept or performed by the Car Company, and if any such default in payment or performance shall continue for the period of six months after demand, the Trustee may, and upon written request of the holders of a majority in amount of the bonds then outstanding, being first indemnified by them to its satisfaction, shall sell or foreclose upon, according to the proceedings by law prescribed, all or any portion of the property held by it under this indenture, and such proceedings of sale or foreclosure shall be a perpetual bar both at law and in equity against the Car Company and against all persons claiming by, from or under it. After deducting from the proceeds of such sale or foreclosure, the proper allowance for all expenses thereof, including attorney's and counsel fees, and all other expenses or advances which may have been made or incurred by said Trustee in respect of the said property or the appurtenances thereto, and all payments which may have been made by it for taxes or assessments, or in satisfaction of charges and liens, prior to the lien of the mortgages and deeds of trust to the Trustee thereon, or for insurance, as well as reasonable compensation for its own services, the Trustee shall apply the proceeds to the payment of the bonds secured hereunder and the interest due thereon, whether evidenced by coupons or otherwise, without giving preference or priority to one bond over another, but ratably to the aggregate amount of such unpaid principal and accrued and unpaid interest, and if any surplus remain after the payment in full of the principal and interest of said bonds, then the Trustee shall transfer and pay over such surplus to the Car Company.

Thirteenth.—If when the bonds hereby secured shall have become due and payable, the Car Company shall well and truly pay, or cause to be paid, the whole amount of the principal and any interest due upon the bonds hereby secured, and shall also pay or cause to be paid all the sums payable hereunder by the Car Company, and shall well and truly keep and perform all the things herein required to be kept and performed by it according to the true intent and meaning of this indenture, then and in that case, these presents and the trust hereby created shall cease and determine, and the premises and properties hereby conveyed shall revert to the Car Company, and the estate, rights, title and interest of the Trustee shall thereupon cease, determine and become void, and the Trustee in such case on demand of the Car Company and at its cost and expense, shall execute and deliver to the Car Company all proper instruments that may be necessary to evidence the satisfaction of this indenture and secure its release and discharge.

The Trustee may also execute such release and discharge upon production by the Car Company or its assigns of all the bonds issued hereunder, together with the coupons thereunto belonging, cancelled or for cancellation, and the Trustee shall not be under any liability or obligation to enquire into the holding of said bonds by the Car Company or its assigns.

Fourteenth.—The Trustee, for itself and its successors, hereby accepts the trusts and assumes the duties herein created and imposed upon it, but only upon the following terms and conditions, to wit:

(a) The Trustee shall be protected in acting upon any notice, request, consent, certificate, bond or other paper or document believed by it to be genuine and to have been signed by the proper party.

(b) The Trustee may select and employ in and about the execution of this trust suitable agents and attorneys, whose reasonable compensation shall be paid to the Trustee by the Car Company, or in default of such payment shall be a charge upon the property covered by this indenture, and the proceeds thereof, paramount to said bonds. The Trustee shall not be responsible for the recording or filing of this indenture. The Trustee, save for its gross negligence or wilful default, shall not be personably liable for any loss or damage.

(c) The Trustee shall have a first lien upon the property covered by this indenture and its proceeds, for its reasonable expenses, counsel fees and compensation incurred in and about the execution of the trust hereby created, and the exercise and performance of its powers and duties hereunder.

(d) The Trustee shall be under no obligation or duty to perform any act hereunder, or defend any suit in respect hereof, unless reasonably indemnified. The Trustee shall not be bound to recognize any person as a bondholder unless nor until his bonds are submitted to the Trustee for inspection, if required, and his title satisfactorily established, if disputed.

(e) The recitals of facts in this indenture and in said bonds contained shall be taken as statements by the Car Company and shall not be construed as made by the Trustee.

(f) The Trustee or any successor or successors hereafter appointed may resign and be discharged of the trusts hereby created, by written notice thereof to the Car Company and by publication of such notice at least twice in each week for four successive weeks in a daily newspaper published in the City of New York, and by duly accounting for the trust funds in the possession of the Trustee or the Trustees so resigning.

Fifteenth.—In case of the resignation of the Trustee, or of its dissolution or insolvency, or its removal for cause as Trustee hereunder, it shall be the duty of the Car Company to call a meeting of the bondholders by printed notice, published in two of the public newspapers of New York City, once a week for three consecutive weeks next preceding such meeting, calling such meeting to be held in the said City of New York, and by mailing notice of the same to each of the registered bondholders not less than ten days before the date of such meeting. At the time and place specified in said notice, the holders of said bonds, in such meeting assembled, shall organize and proceed to elect a suitable corporation to act as Trustee under this agreement, and a majority in amount of such bonds legally represented at such meeting shall be competent to elect such new Trustee, and the corporation so elected shall immediately upon election and on its acceptance in writing of such trust become vested with all the estate, trusts, rights, powers and duties of the present Trust therein, and shall be entitled to receive from the present Trustee or its legal representatives all moneys, mortgages and assurances appertaining or relating to this trust and the due execution thereof.

Sixteenth.—No recourse under or upon any obligation, covenant or agreement contained in this indenture, or in any bond or coupon hereby secured, or because of the creation of any indebtedness hereby secured, shall be had against any incorporator, stockholder, officer or director of the Car Company, or of any successor corporation, either directly or through the Car Company, by the enforcement of any assessments or by any legal or equitable proceeding by virtue of any statute or otherwise; it being expressly agreed and understood that this indenture and the obligations hereby secured are solely corporate obligations and that no personal liability whatsoever shall attach to or is incurred by the incorporators, stockholders, officers or directors of the Car Company or of any successor corporation or any of them, by or because or on account of this indenture.

Seventeenth.—It is covenanted and agreed between the parties hereto that the words "Car Company" when used in these presents mean the party issuing the bonds herein referred to; that the word "Trustee" means the corporation charged with the execution of the trust herein, whether the same be the National Trust Company of New York, or any successor or successors in the trust hereby created; that the word "bonds" means the bonds issued hereunder; and the words "Trustee," "bond," "bondholder" and "holder" shall include the plural as well as the singular number and the term "majority" shall signify the majority in amount.

Eighteenth.—It is covenanted and agreed that this indenture may be executed in several counterparts, each of which so executed shall be deemed to be an original, and such counterparts shall together constitute but one and the same instrument.

In Witness Whereof, the said parties hereto have caused their respective corporate seals, duly attested, to be affixed to an original and duplicate hereof, and these presents to be subscribed by their duly authorized representatives, the second day of January, A. D. 1908.

HARNEY CAR MANUFACTURING COMPANY,

{ Corporate Seal. }

By John M. Harney,
President.

Attest:
James Harney,
Secretary.

NATIONAL TRUST COMPANY OF NEW YORK,

{ Corporate Seal. }

By J. G. Lippincott,
President.

Attest:
Henry L. Sherwin,
Secretary.

(Acknowledgments by president and secretary of the Harney Car Manufacturing Co. and joint acknowledgment by president and secretary of National Trust Co. of New York.)

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