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CORPORATIONS - CORPORATE FORM USED TO EVADE BANK DOUBLE LIABILITY

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CORPORATIONS — CORPORATE FORM USED TO EVADE BANK DOUBLE LIABILITY — Plaintiff, the receiver for an insolvent bank, sued the individual stockholders of an investment corporation on an assessment to the amount of the par value of the bank stock as provided by the constitution and statutes of South Carolina. The investment corporation had been organized several years

previously to secure control of a group of banks. Its holdings throughout consisted only of bank stock, and finally solely of stock of the closed bank. Plaintiff claimed, since the corporation had no assets, that the stockholders of the investment corporation were individually liable, because the use of a holding company for the purpose of owning bank stock, thus avoiding personal liability, was a fraud on the depositors and contrary to the policy of the statute. *Held*, since it was not shown that the holding company was organized for the primary purpose of evading the statute, and because the stockholders of the holding company never contracted to assume this liability, the complaint must be dismissed. *Nettles v. Rhett*, (D. C. S. C. 1937) 20 F. Supp. 48.

Although the principle has long been established that the courts will not hesitate to look through the corporate entity if it is being used as a means of perpetrating a fraud, or to evade the policy of a statute,[1] the question is presented in a new form where the double liability of bank stock is attempted to be assessed against the individual stockholders of a holding company. And a similar problem is presented where the stock of several banks is transferred to trustees who in return issue "participating certificates" entitling the holder to dividends declared by the several banks. The problem is presented in the following three situations: (1) where the stock is transferred to a holding company for the primary purpose of evading the liability;[2] (2) where the stock is transferred to a holding company or trustees in order to achieve unified control of a group of banks, the transferors in turn promising to assume the liability; [3] and (3) as in the principal case, where the holding company is formed, not primarily to evade liability, but to achieve either control of a group of banks or some other secondary purpose, with no express assumption of liability.[4] The first situation offers no difficulty since it has uniformly been held that the corporate form will be looked through, if it is being used primarily to evade a statute.[5] Although the second situation has resulted in much litiga-

[1] Wormser, "Piercing the Veil of Corporate Entity," 12 COL. L. REV. 496 (1912). See notes in 1 A. L. R. 610 (1919) and 34 A. L. R. 597 (1925).

[2] Corker v. Soper, (C. C. A. 5th, 1931) 53 F. (2d) 190, cert. denied, 285 U. S. 540, 52 S. Ct. 313 (1931); noted in 10 N. C. L. REV. 288 (1932); Harris Investment Co. v. Hood, 123 Fla. 598, 167 So. 25 (1936); Nettles v. Sottile, (S. C. 1937) 191 S. E. 796.

[3] Simons v. Groesbeck, 268 Mich. 495, 256 N. W. 496 (1934); Barbour v. Thomas, (D. C. Mich. 1933) 7 F. Supp. 271, affirmed, (C. C. A. 6th, 1936) 86 F. (2d) 510, cert. denied, 300 U. S. 670, 57 S. Ct. 513 (1937).

[4] Fors v. Farell, 271 Mich. 358, 260 N. W. 886 (1935); Keyes v. American Life & Accident Ins. Co., (D. C. Ky. 1932) 1 F. Supp. 512; Metropolitan Holding Co. v. Snyder, (C. C. A. 8th, 1935) 79 F. (2d) 263, 103 A. L. R. 912 at 921; Laurent v. Anderson, (C. C. A. 6th, 1934) 70 F. (2d) 819. In this last case participating certificates were issued which stated the holder assumed the liability; the defendant claimed since he never signed the agreement he was not liable. The court held this fact was immaterial, but that defendant was liable under 38 Stat. L. 251, § 23 (1915), 12 U. S. C., § 64 (1935), as the real and beneficial owner of the stock.

[5] Palmolive Co. v. Conway, (D. C. Wis. 1930) 43 F. (2d) 226; United States v. Lehigh Valley R. R., 220 U. S. 257, 31 S. Ct. 387 (1910); and see Justice Sanborn's oft-quoted statement in United States v. Milwaukee Refrigerator Transit Co., (C. C. Wis. 1905) 142 F. 247 at 255.

tion, there seems no difficulty in holding stockholders who have expressly contracted to assume this liability, since this assumption accomplishes the result intended by the statute.[6] Finally, it is equally clear that in the third situation the corporate form should be disregarded when the question is considered in the light of the purpose of the statute assessing double liability. Whether the view be taken that the liability is statuory,[7] or merely contractual in its nature,[8] this additional liability is intended to form an additional safeguard for the protection of depositors and creditors.[9] Hence, it is immaterial what may have been the motive for the formation of the holding company,[10] if the result of its

[6] Simons v. Groesbeck, 268 Mich. 495, 256 N. W. 496 (1934); Barbour v. Thomas, (D. C. Mich. 1933) 7 F. Supp. 271, affirmed, (C. C. A. 6th, 1936) 86 F. (2d) 510, cert. denied, 300 U. S. 670, 57 S. Ct. 513 (1937). These two cases and Fors v. Farell, 271 Mich. 358, 260 N. W. 886 (1935), involved the attempt of Detroit bankers to get control of most of the banks of Michigan by the Detroit Bankers Co., a holding company. While the set-up was quite complex (a complete account of it is given in the court of appeals decision), the question presented in the first two cases was whether the receiver of the First National Bank-Detroit could levy an assessment against the holders of the stock of the Detroit Bankers Co., which held all of its stock, and on whose certificates it was stated the holder assumed any liability which might be imposed on the holding company. Evidently to avoid any such result as in the principal case, this clause was put in at the insistence of the attorney-general, the corporation and securities commission and the superintendent of banks. A comment on the first two cases may be found in 33 MICH. L. REV. 273 (1934).

[7] Much confusion is found in the decisions on this point, and earlier decisions of the Supreme Court indicated that the liability is contractual in its nature. Richmond v Irons, 121 U. S. 27, 7 S. Ct. 788 (1887); Matteson v. Dent, 176 U. S. 521, 20 S. Ct. 419 (1899). Other cases have indicated that liability is founded on both the statute and on contract; Concord First Nat. Bank v. Hawkins, 174 U. S. 364, 19 S. Ct. 739 (1899); McDonald v. Thompson, 184 U. S. 71, 22 S. Ct. 297 (1902). However, in Forrest v. Jack, 294 U. S. 158, 55 S. Ct. 370 (1935), the court seems finally to have come to the conclusion the liability is entirely statutory. This view is also expressed in Laurent v. Anderson, (C. C. A. 6th, 1934) 70 F. (2d) 819, and Page v. Jones, (C. C. A. 8th, 1925) 7 F. (2d) 541, and is also the one taken by the text writers. MAGEE, BANKS AND BANKING, 2nd ed., § 68 (1913); 7 MICHIE, BANKS AND BANKING, § 73 (1932); 2 MORSE, BANKS AND BANKING, 6th ed., § 675 (1928).

[8] The South Carolina Supreme Court has taken the view that the liability imposed is contractual in its nature. Fischer v. Chisholm, 159 S. C. 395, 157 S. E. 139 (1930). Since the bank stock was issued directly to the holding company in the principal case, the court stated, as an additional reason for not imposing liability, that the stockholders in the holding company never contracted to assume this liability, in this way distinguishing the case from those situations where the stock was first owned by an individual and then transferred to a holding company in order to evade the contractual liability. However, this argument does not carry much force, since the statute thus could always be evaded by the simple expedient of the holding company taking the stock directly in the first instance.

[9] Schram v. Plym, (D. C. Mich. 1934) 7 F. Supp. 478; Metropolitan Holding Co. v. Snyder, (C. C. A. 8th, 1935) 79 F. (2d) 263, 103 A. L. R. 912 at 921.

[10] "The incorporators of the holding company may have acted in good faith according to their standards of right, but . . . they must be judged of the legal effect

creation is an evasion of the policy of the statute. Since the holding company's only assets generally consist solely of the stock of the closed bank,[11] if recourse is not had to the stockholders of the holding company, the depositors are left remediless.[12] The principal case, in requiring a showing of fraudulent intent, and in relying on dicta in a previous case,[13] has evidently arrived at an erroneous conclusion which is not supported by any other court which has considered the question.[14] It is not necessary that actual fraud be proven before the corporate entity will be disregarded; mere "constructive fraud" is sufficient.[15] That is, if the effect of a particular act is the same as in the case of actual fraud, the motivation is immaterial and liability will be imposed the same as in the

of what they deliberately did." Metropolitan Holding Co. v. Snyder, (C. C. A. 8th, 1935) 79 F. (2d) 263 at 268, 103 A. L. R. 912 at 921.

[11] For example, in Corker v. Soper, (C. C. A. 5th, 1931) 53 F. (2d) 190, cert. denied, 285 U. S. 540, 52 S. Ct. 313 (1931), the holding company had an authorized capital stock of $10, and the only money it ever possessed was $20 paid by the defendant for organization expenses. Again, in Harris Investment Co. v. Hood, 123 Fla. 598, 167 So. 25 (1936), and in Nettles v. Sottile, (S. C. 1937) 191 S. E. 796, the sole asset of the corporation was the stock of the closed bank.

[12] This is especially true in South Carolina where it is held that since the holding of bank stock by a corporation is ultra vires, there can be no recovery against the corporation even if it has sufficient assets to pay the assessment. White v. Bank, 66 S. C. 491, 45 S. E. 94 (1903); Alderman v. Alderman, 178 S. C. 9, 181 S. E. 897 (1935).

[13] Nettles v. Sottile, (S. C. 1937) 191 S. E. 796. This case was a suit brought by the same receiver for the same bank as in the principal case. In this case the supreme court approved the statement in the opinion of the circuit court (which is printed in full in the report) to the effect that the corporate entity will be disregarded where it is being used in an endeavor to evade a statute or to modify its intent. But the court added, 191 S. E. at 809, "If it is intended to say that in every instance in which a private corporation in this state has bought bank stock as an investment the stockholders may be held individually liable for the stock, the proposition is too broad." And the court indicated it would not impose liability upon stockholders who were *ignorant of the fact* that the corporation owned the stock. However, in the principal case all the defendants were the organizers of the holding company and clearly no defence of ignorance could be set up. Hence, it appears that even this dicta does not support the holding in the principal case.

[14] See cases cited in notes 2, 3 and 4, supra.

[15] Thus in Nettles v. Sottile, (S. C. 1937) 191 S. E. 796, there was not fraud in the sense that the stock was transferred to the holding company because the holder feared insolvency, but the circuit court held the mere transfer to the holding company constituted "constructive fraud" and that in either case the relief was the same. The lower court's opinion, which is approved by the supreme court with certain limitations, contains the best treatment of the problem. Again, in Harris Investment Co. v. Hood, 123 Fla. 598, 167 So. 25 (1936), the holding company was formed six years before the insolvency of the bank, but the court also held the mere use of the holding company to hold the stock in itself constituted fraud. See also People ex rel. Atty. Gen'l v. Michigan Bell Tel. Co., 246 Mich. 198, 224 N. W. 438 (1929); 1 FLETCHER, CYCLOPEDIA CORPORATIONS, rev. ed., § 44, note 15 (1931), and cases there cited.

case of actual fraud.[16] Finally, if the defense of good faith can be set up, as was done in the principal case, not only is the law nullified where stock is held by a holding company, but also there is created a situation whereby some stockholders are forced to pay and others are not, although plainly the statute never contemplated any discrimination in assessment.[17]

[16] 2 POMEROY, EQUITY JURISPRUDENCE, 4th ed., § 922 (1918).

[17] This is shown by the decisions contrary to the principal case and Nettles v. Sottile, (S. C. 1937) 191 N. E. 796. While both were suits against holding companies, in the latter case the stockholder of the holding company had to pay an assessment of $9,000, while in the principal case the stockholders evaded an assessment of $740,000.

It must be noted in passing that the question in the principal case has ceased to be one of major importance with the repeal of the federal statute imposing double liability in so far as national banks are concerned. 48 Stat. L. 162, § 22 (1934), 12 U. S. C., § 64a (1935). This has been followed by similar action in a few states. Ohio: Section 3 of Article XIII of the state constitution was repealed at general election of Nov. 3, 1936; 116 Ohio Laws (1935-1936), part 2, p. 375. Pennsylvania, Pa. Laws (1935), No. 31, § 614. South Carolina: S. C. Acts (1935), No. 28, ratifying repeal of section 18, article IX of the State Constitution approved at the general election of April 7, 1934; S. C. Acts (1935), No. 37, repealing S. C. Code (1932), § 7868.