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# CORPORATIONS - LIABILITY OF STOCKHOLDERS OF BANK STOCK HOLDING COMPANY FOR STATUTORY ASSESSMENT ON BANK STOCK.

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CORPORATIONS — LIABILITY OF STOCKHOLDERS OF BANK STOCK HOLDING COMPANY FOR STATUTORY ASSESSMENT ON BANK STOCK — The late depression with its attendant bank failures and the consequent assessment of shareholders has resulted in bringing before the courts

a question that has never been litigated until comparatively recent times. That is, can the shareholders of a holding company, whose assets consist of stock of the closed bank, be subjected to the statutory assessment when the corporation itself is unable to meet the assessment?[1] The case of *Nettles v. Rhett*[2] is the latest of this series, and is fairly typical of the issues involved. This case concerned a suit by the receiver of the Peoples State Bank of South Carolina against the stockholders of the Peoples Investment Company, whose assets consisted solely of 74,000 shares of the closed bank. This company had been chartered by the officers of the bank in 1929, while the bank was in a solvent condition, for the purpose of financing the expansion of the Peoples State Bank; it was thereafter used to control the bank, although ownership of bank stock by a corporation was forbidden under the constitution of South Carolina. The shareholders of the holding company claimed that since the holding company was formed in good faith for legitimate business reasons, and not for the purpose of evading liability, they should not be subject to an assessment. This contention was upheld by the federal district court.[3] However, the circuit court of appeals concluded that, since ownership of bank stock by a corporation was ultra vires[4] and the corporation consequently immune to assessment under South Carolina law,[5] the shareholders could not evade their liability by

[1] The following are the pertinent statutory provisions on the question of stockholders' liability in national banks: "The shareholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares. . . ." 38 Stat. L. 251, § 23 (1913), 12 U. S. C. (1935), § 63. "The stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. . . ." 38 Stat. L. 251, § 23 (1913), 12 U. S. C. (1935), § 64. However, it must be noted that these two sections are now repealed by § 64a. 48 Stat. L. 162, § 22 (1933).

[2] (C. C. A. 4th, 1938) 94 F. (2d) 42.

[3] Nettles v. Rhett, (D. C. S. C. 1937) 20 F. Supp. 48.

[4] S. C. Civ. Code (1932), § 7677(5): "No part of the capital stock or any of the funds of such corporation shall, at any time during the continuance of their charter, be used or employed, directly or indirectly, in banking operations, or for any purpose whatsoever inconsistent with the provisions of their respective charters." Other provisions of the statutes and constitution of South Carolina imposing double liability on shareholders of banks have, like sections 63 and 64 above in the national act, since been repealed. 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.

[5] The Supreme Court of South Carolina has laid down the rule 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).

transferring to an owner legally incapable of assuming the obligation. The court also asserted by way of dictum that it would have reached the same result even if the corporation could have legally owned the stock, on the principle that transfer of bank stock to an owner known to be financially unable to respond to an assessment leaves the transferor still liable. This result is in accord with all the other cases which have considered the question under various fact situations, and it is the purpose of this note to discuss the various theories on which liability has been predicated.

## 1.

In the first group to be considered are those cases where the individual owner of the stock formed a corporation and then transferred the stock to it for the express purpose of avoiding liability, the bank being perfectly solvent at the time of the transfer. The courts have had little difficulty in finding liability in this situation, since it presents a deliberate attempted evasion of the assessment statute. For this reason it is only natural that in *Harris Investment Co. v. Hood*[6] and in *Nettles v. Sottile*[7] the respective courts should proceed on the theory that the corporate entity will be disregarded under these facts. This method of approach is perfectly consistent with the doctrine that the corporate form will be disregarded where it is being used to evade the policy of a statute.[8] However, since this theory is somewhat narrow in its application, and in view of the fact that the "beneficial owner" of the stock can always be held liable regardless of whether the stock stands in his name or not,[9] other courts have refused to proceed on this analysis. Thus in *Corker v. Soper*,[10] the court asserted it was not disregarding the corporate entity in holding the shareholder of the holding company liable, but in reality was giving effect to it on the theory that the corporation was only an agent to hold the legal title for the defendant who at all times remained the real owner. Again, in *Durrance v. Collier*[11] the court said the transfer to the holding company was merely "colorable" and defendant was liable as beneficial owner.

[6] 123 Fla. 598, 167 So. 25 (1936).

[7] 184 S. C. 1, 191 S. E. 796 (1937).

[8] 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). See also 1 FLETCHER, CYCLOPEDIA CORPORATIONS, rev. ed., § 44, note 15 (1931), and cases cited.

[9] Houghton v. Hubbell, (C. C. A. 1st, 1899) 91 F. 453; Ohio National Bank v. Hulitt, 204 U. S. 162, 27 S. Ct. 179 (1907).

[10] (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).

[11] (C. C. A. 5th, 1936) 81 F. (2d) 4.

And finally in *Brusselback v. Cago Corporation*,[12] a like result was reached on the same theory.

As mentioned above, the use of the corporate form in an attempt to evade bank stock ownership liability is of recent origin. Nevertheless, the principles of law on which liability is predicated have long been settled. In the first place, the fact the real owner does not have the shares registered in his name on the books of the bank has never been held to be an obstacle to holding a transferor liable if he in fact still remains the "beneficial owner."[13] In such case the transferee is considered to be only an agent to hold the legal title.[14] And long before the use of corporations to hold bank stock, the Supreme Court asserted: "A transfer for the mere purpose of avoiding . . . liability to the company or its creditors is fraudulent and void, and he [the transferor] remains still liable."[15] Again, where the defendant bank transferred the stock to a pecuniarily irresponsible employee of the bank to avoid liability, the Court said in holding the bank liable: "As to such owner the law looks through subterfuges and apparent ownerships and fastens the liability upon the shareholder to whom the shares really belong."[16] And where, as in the principal case, the one to whom the stock is transferred is legally incapable of responding to any assessment, the transferor can be held liable on the same principle that the transferor to an infant is held. That is, since the law contemplates that at all times there shall be someone legally able to respond to an assessment,[17] if the stock is transferred to someone legally unable to do so, the transferor still remains liable.

All the foregoing cases concern *transfers* to corporations in order to evade liability, and come squarely within the principle that a merely colorable change of ownership cannot divest oneself of liability. How-

[12] (C. C. A. 2d, 1936) 85 F. (2d) 20.

[13] Early v. Richardson, 280 U. S. 496, 50 S. Ct. 176, 69 A. L. R. 658 at 661 (1930); Rankin v. Fidelity Trust Co., 189 U. S. 242, 23 S. Ct. 553 (1903). See also cases cited in note 9, supra.

[14] Davis v. Stevens, (C. C. N. Y. 1879) 17 Blatchf. 259, 7 Fed. Cas. No. 3653.

[15] National Bank v. Case, 99 U. S. 628 at 632, 25 L. Ed. 448 (1878).

[16] Ohio Nat. Bank v. Hulitt, 204 U. S. 162 at 168, 27 S. Ct. 179 (1907).

[17] "It is a well established rule of law that a transfer of stock in a corporation must be made to a person or corporation not only legally capable of holding the stock transferred, but also to one who is legally bound to respond when assessments are made upon the stock, and who may lawfully assume the liabilities of the transferor in relation thereto. It need not necessarily have been transferred to a person who is responsible in the sense that he will be able to financially meet the liabilities imposed upon a stockholder, but it is essential that he shall be legally liable to assume such obligations, and not be at liberty to repudiate them." Aldrich v. Bingham, (D. C. N. Y. 1904) 131 F. 363 at 364. See also Early v. Richardson, 280 U. S. 496, 50 S. Ct. 176, 69 A. L. R. 658 at 661 (1930); Riley v. Bondi, (C. C. A. 8th, 1933) 64 F. (2d) 515. Cf. Pottorff v. Dean, (D. C. Mass. 1934) 8 F. Supp. 670.

ever, whether the stock is transferred to a holding company or taken in its name in the first instance seems to be quite immaterial.[18] The term "beneficial owner" is conveniently vague and has been given so broad an application that it easily covers this situation. In fact, from the above cases may be deduced the broad proposition that whenever a corporation has been formed for the purpose of avoiding liability, the ones enjoying the benefits of ownership of the stock are always liable irrespective of the form of the transaction.

2.

In contrast to the previous cases, the following concern the question of liability where the corporate form, or the "Massachusetts Trust" arrangement has been used primarily to promote a legitimate business interest. Thus the cases of *Simons v. Groesbeck*,[19] *Barbour v. Thomas*,[20] and *Fors v. Farrell*[21] resulted from the attempt of Detroit bankers to bring a number of Michigan banks under a unified control by means of the Detroit Bankers Company, a holding company formed for the purpose of securing control of a number of independent banks. There was inserted both in the articles of association and in the stock certificates of the holding company a provision which stated the shareholder promised to assume any liability which might be imposed on the holding company.[22] Eventually the Detroit Bankers Company and some of the member banks became insolvent and were forced into

[18] Metropolitan Holding Co. v. Snyder, (C. C. A. 8th, 1935) 79 F. (2d) 263, 103 A. L. R. 912 at 921.

[19] 268 Mich. 495, 256 N. W. 496 (1934).

[20] (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). The district court opinion is noted in 2 UNIV. CHI. L. REV. 484 (1935), while the Simons case and the district court opinion are both commented on in 33 MICH. L. REV. 273 (1934). See also comment in 46 YALE L. J. 718 (1937).

[21] 271 Mich. 358, 260 N. W. 886 (1935), noted in 20 MINN. L. REV. 217 (1936).

[22] The following provision was incorporated into the charter and also printed on the reverse side of each certificate of stock issued by the holding company: "Article IX-A. The holder of each share of common stock of this corporation shall be individually and severally liable for such stockholders' ratable and proportionate part determined on the basis of their respective stock holdings of the total issued and outstanding stock of this corporation, for any statutory liability imposed upon this corporation by reason of its ownership of shares of capital stock of any bank or trust company, and the stockholders of this company by the acceptance of their certificates of stock of this company, severally agree that such liability may be enforced in the same manner and to the same extent as statutory liability may now or hereafter be enforceable against stockholders of banks or trust companies under the laws under which said banks or trust companies are organized to operate."

receivership after the bank holiday of 1933. In the *Simons* case the owners of the common stock of the holding company sought to restrain the receiver from collecting assessments on the stock after the Detroit Bankers Company itself had been assessed when the First National Bank—Detroit became insolvent. The court, in refusing an injunction, based its decision entirely on the contractual provision rather than upon the public policy evidenced by the double liability statute. This decision seemed to give rise to the implication that a corporate entity would be a complete bar to a bank receiver's suit against the real owner.[23] This question was specifically raised in the *Fors* case the following year when suit was brought by the receiver of the American State Savings Bank of Lansing against the Detroit Bankers Company as the real owner of the former's stock. The court allowed the suit despite the fact the stock stood on the books of the bank in the name of Farrell, as trustee for the Assets Realization Corporation, whose stock was owned by the directors of the First National Bank—Detroit in trust for its stockholders, and whose stock in turn was owned by the defendant. The court, in holding that the corporate entity and trust arrangements could be disregarded under these facts, stated its position as follows: "In a proceeding to enforce stockholders' liability it is of little or no importance as to how many paper ownerships or holdings in trust intervene between the bank that issued the stock and the ultimate or actual owner thereof."[24] The question whether a bank receiver could avail himself of the benefits of the contract provision was not raised in this case, since the suit was against the corporation itself and not against its individual members. That such a suit would have been possible in the Michigan court is highly doubtful, for the court in the *Simons* case had taken the position that this contractual liability of the stockholders was part of the general assets of the holding company. That is to say, both the promise and performance were intended for the holding company, and not for the benefit of the respective banks, and hence a receiver of one of the latter would have no rights as a third party beneficiary.[25] This question was specifically passed on in the fed-

[23] See comment, 33 MICH. L. REV. 273 at 276 (1934).

[24] 271 Mich. 358 at 369, 260 N. W. 886 (1935).

[25] 6 R. C. L. 886 (1915); German Alliance Ins. Co. v. Home Water Supply Co., 226 U. S. 220, 33 S. Ct. 32 (1912). In Michigan actions at law have been held not to be maintainable by a third party beneficiary. Linneman v. Moross Estate, 98 Mich. 178, 57 N. W. 103 (1893). However, such actions have been allowed where the promise was made directly to the plaintiff even though he was a stranger to the consideration. Monaghan v. Insurance Co., 53 Mich. 238, 18 N. W. 797 (1884); Beckovsky v. Abstract & Title Co., 208 Mich. 224, 178 N. W. 238 (1919). In equity, a third party beneficiary has been allowed to sue where the promise was directly made for such third party's benefit. Smith v. Thompson, 250 Mich. 302, 230 N. W. 156, 73 A. L. R. 1389 at 1395 (1930); Johnson v. Banks-McCutcheon, Inc., 260

eral district court when suit was brought to restrain the receiver of the First National Bank—Detroit from collecting on the assessment against the individual stockholders of the Detroit Bankers Company. The court refused the injunction and based its decision mainly on the contractual provision; its theory was that the performance of the obligation was intended for the protection of the banks primarily and was not an asset to which general creditors would have a right,[26] and hence the receiver could enforce the contract as a third party beneficiary. But the court also indicated it would have reached the same result irrespective of the contract on the ground that the plaintiffs were the real owners. This seems somewhat inconsistent with the Michigan decision which said that the holding company was the real owner, but it is perfectly in accord with the state case in its holding that the corporate entity may be disregarded if the corporation itself is unable to meet the assessment. The Circuit Court of Appeals, in affirming, also took the position on that the corporate entity could be disregarded under these circumstances, and hence it was not necessary to rely on the contractual provision at all. Again, in *Metropolitan Holding Company v. Snyder*,[27] where a holding company was formed for the purpose of financing the sale of the stock of the bank, the court proceeded on the theory that the corporate entity was no bar since the defendants in reality were the beneficial owners.

That the form of the arrangement, as well as the motive prompting its existence, is immaterial is also indicated by the cases holding the beneficial holders of participating certificates in a "Massachusetts Trust" liable as the real owners.[28] Prima facie, the result here would seem to depend upon the interpretation which should be given to section 66[29] of the federal banking act; this provides that in the case of bank stock

Mich. 120, 244 N. W. 253 (1932); Hamburger v. Russell, 255 Mich. 696, 239 N. W. 267 (1931); Barnard v. Huff, 252 Mich. 258, 233 N. W. 213, 77 A. L. R. 259 at 265 (1930). For recent legislation enlarging the rights of a third party beneficiary in Michigan, see Mich. Pub. Acts (1937), No. 296.

[26] Barbour v. Thomas, (D. C. Mich. 1933) 7 F. Supp. 271 at 275. Cf. Backus v. Connolly, 268 Mich. 495 at 504, 256 N. W. 496 (1934).

[27] (C. C. A. 8th, 1935) 79 F. (2d) 263.

[28] See Keyes v. American Life & Accident Ins. Co., (D. C. Ky. 1932) 1 F. Supp. 512, affirmed sub nomine, Laurent v. Anderson, (C. C. A. 6th, 1934) 70 F. (2d) 819; Banco Kentucky Receiver v. Louisville Trust Co.'s Receiver, 263 Ky. 155, 92 S. W. (2d) 19 (1936); O'Keefe v. Pearson, (C. C. A. 1st, 1934) 73 F. (2d) 673; Maddison v. Bryan, 31 N. M. 404, 247 P. 275 (1926).

[29] "Persons holding stock as executors, administrators, guardians, or trustees, shall not be personally subject to any liabilities as stockholders; but the estates and funds in their hands shall be liable in like manner and to the same extent as the testator, intestate, ward, or person interested in such trust funds would be, if living and competent to act and hold the stock in his own name." U. S. Rev. Stat. (1878), § 5152, 12 U. S. C. (1935), § 66.

held in trust, the trustee shall not be personally liable, but makes no mention as to whether the beneficiary shall also be exempt. In the case of a strict trust, there has been a conflict of decision on the question of the liability of the beneficiary where the trust has been created by a third party.[30] However, in every case where the "Massachusetts Trust" has been used as a device to secure control of a number of banks, the courts have held the owners of the participating certificates liable. Except in one case, there was also present a contractual provision in the agreement similar in effect to the one inserted in the stock certificates of the Detroit Bankers Company,[31] but the courts held it unnecessary to rely on this provision. Regardless of the interpretation which should be given to section 66 where a true trust has been set up by a third party, this result seems perfectly correct where the beneficiary is also the settlor of the trust. Otherwise, liability could always be evaded by the simple expedient of setting up a trust for one's self. Moreover, it also seems quite clear that section 66 was never intended to apply to this type of trust, since it is primarily a form of business organization and not within the contemplation of whatever exemptions were intended to be given by this provision. In any event, the holder of a participating certificate in such a trust has always been held liable as the beneficial owner under sections 63 and 64.

[30] The rule in the federal courts is to the effect that section 66 also operates to exempt the beneficiary from personal liability, and hence it is immaterial whether the beneficiary is sui juris or not where a trust has been created for a minor's benefit. Heiden v. Cremin, (C. C. A. 8th, 1933) 66 F. (2d) 943; Fowler v. Gowing, (C. C. A. 2d, 1908) 165 F. 891; Lucas v. Coe, (C. C. N. Y. 1898) 86 F. 972; McNair v. Darragh, (C. C. A. 8th, 1929) 31 F. (2d) 906, cert. denied sub nomine Gamble v. Darragh, 280 U. S. 563, 50 S. Ct. 19 (1929). However, a few cases have held the trustee liable despite section 66 or identical state statutes, where the trustee has been also the creator of the trust and the beneficiaries have been minors, for the reason that the latter, due to their infancy, would thus not be liable to assessment. See Furr v. Chapman, (Tex. Civ. App. 1925) 276 S. W. 475; Shaw v. McMillan, (Tex. Civ. App. 1930) 24 S. W. (2d) 536; Kerr v. Urie, 86 Md. 72, 37 A. 789, 38 L. R. A. 119, 63 Am. St. Rep. 493 at 498 (1897). The district court in the Keyes case took the position that even in the ordinary trust arrangement the beneficiary is personally liable under section 64.

[31] In the Keyes case an agreement provided that a holder of trustees' participation certificates should be "subject to the same liability thereon as he would have been subject to in case he had been the owner of such proportionate part of the shares held by the Trustees in any corporation as the number of shares called for by his Trustees Participation Certificates bears to the whole number of shares covered by all outstanding Trustees Participation Certificates; and to such extent he shall indemnify and hold harmless the Trustees owning such stock from any loss or liability on account of being the holders or owners thereof. The measure of liability assumed hereunder shall be the same as that provided by law with reference to the holders of stock in any particular corporation in which the Trustees may hold stock as is provided by law with reference to the holders of such stock and no more." (D. C. Ky. 1932) 1 F. Supp. 512 at 513.

In conclusion, it may be stated that in view of the unanimity of authority, no sort of device, however legitimate otherwise, will be allowed to defeat an assessment, since the overriding consideration has been the protection of the creditors and the depositors of the bank. In the cases where the corporate form has been interposed as a defence, it seems only logical that most of the courts should proceed on the theory that the entity should be disregarded in order to fasten liability on the individual owners of the stock of the holding company. However, that such an approach is by no means inevitable is shown by the cases basing their decision on agency or plain statutory policy. On final analysis these divergences appear to be mainly verbal; the cases which state that it is not necessary to "pierce the corporate veil" cite as authority for their holdings cases which proceed on this very ground and vice versa. What is important is the fact that protection of the depositors and creditors has not been allowed to be defeated by the mere form in which the legal title to the stock is taken. With the repeal of sections 63 and 64 of the federal banking act by section 64a,[32] the question has ceased to be of major importance in so far as national banks are concerned. However, since statutes imposing double liability still persist in many states the question is of more than academic interest. And in view of the unbroken line of authority imposing liability on the one who is receiving the benefits of ownership, it is safe to predict that whenever the assets of a holding company corporation or "Massachusetts Trust" are not sufficient to meet an assessment, the individual owners who have participated or acquiesced in the arrangement will be held liable.

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[32] See note 1, supra.