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BANKS AND BANKING - BANK STOCK HOLDING COMPANY AS FRAUD ON DOUBLE LIABILITY STATUTE

COMMENTS

BANKS AND BANKING — BANK STOCK HOLDING COMPANY AS FRAUD ON DOUBLE LIABILITY STATUTE — The question as to when, to prevent evasion of a statutory liability, a court will look behind a corporate entity in order to hold individual stockholders liable has been raised in two recent cases. The first, a federal case,[1] involved the Detroit Bankers Company, a Michigan corporation formed for the purpose of holding and investing in bank stocks. Each corporate stock certificate of the holding company contained an "agreement" that the holder of the stock would be liable for his pro rata share of any assessment for which the corporation might become liable as a result of the failure of a bank in which it held stock. The corporation owned almost the entire capital stock of several banks which became insolvent and on the stock of which assessments were made. The holding company failed, and a receiver was appointed. The court in the instant case refused to enjoin the receiver of The First National Bank–Detroit, 97 per cent of whose stock was held by the corporation, from collecting a stock assessment directly from the stockholders of the Bankers Company.

[1] Barbour v. Thomas, (D. C. E. D. Mich. 1934) 7 F. Supp. 271.

Since the court found no actual fraud in organizing the company, the question arises as to the policy behind the statute imposing double liability on bank stockholders.[2] The legislature intended to set up a guaranty fund for bank creditors, in case the property of the bank should be insufficient to pay its debts, and the law is to be construed in the light of such intent.[3] There is a problem as to what type of security the legislature contemplated for the fulfillment of this obligation, should it arise. The statute by its terms seems to anticipate the ownership of stock by individuals,[4] and control of the banks by independent directors.[5] The idea of some diversification of risk so as to afford a reasonable possibility of enforcing the extra liability would seem to be inherent in the statute.[6] To say that the stockholders of a bank, simply by forming another corporation, which would have no assets except bank stocks, and turning their stock over to it, can evade the purpose of the statute would be surprising.[7] The court in determining liability may always look to the real owner of the stock,[8] so there would seem to be no objection to looking at the arrangement realistically to determine who, at least for the purpose of the statute, is the true beneficial

[2] See generally, 7 MICHIE, BANKS AND BANKING 55 ff. (1932).

[3] 7 MICHIE, BANKS AND BANKING, p. 56, sec. 73 (1932). That the guarantee may be inadequate to pay the debts indicates only a legislative failure to require capitalization commensurate with potential liabilities.

[4] U. S. C. tit. 12, sec. 64: "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. . . ."

[5] U. S. C. tit. 12, sec. 72, lays down qualifications for directors, one of which is that each director must own at least ten shares of stock in his own name. U. S. C. tit. 12, sec. 73, in prescribing the oath to be taken on becoming directors, requires that it must show, in addition to all the qualifications prescribed in sec. 72, that the stock standing in his name is not hypothecated, or in any way pledged, as security for any loan or debt.

[6] In electing a new director, the holding company issued the requisite shares of stock to him, and he in return had to execute an irrevocable assignment of the certificate and dividends to the bank.

[7] See 10 N. C. L. REV. 288 (1931-32) forecasting a result such as the one in the principal case.

[8] Ohio Valley Nat. Bank v. Hulitt, 204 U. S. 162, 27 Sup. Ct. 179 (1907). Day, J., on p. 168 says, "we deem it equally settled, both from the terms of the statute attaching the liability and the decisions which have construed the act, that the real owner of the shares may be held responsible, although in fact the shares are not registered in his name. 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." See also Pauly v. State Loan and Trust Co., 165 U. S. 606 at 619, 17 Sup. Ct. 465 at 470 (1897), "the real owner of the shares of the capital stock of a national banking association may, in every case, be treated as a shareholder within the meaning of section 5151 [now U. S. C. tit. 12, sec. 63]."

owner.[9] When the very event which brings the extra liability into actual existence might strip the record owner of any assets with which to meet it, the evasion would seem to be most clear.[10]

In *Laurent, Receiver Banco Kentucky Co. v. Anderson, Receiver*,[11] most of the stock of a bank had been placed in trust, and the former stockholders were given trust participation certificates. The court had no difficulty in saying that these holders were the beneficial owners of the stock, and liable for assessment on the bank stock. In *Corker v. Soper*,[12] *D*, a bank president, had organized a corporation for holding bank stock and carrying on other personal dealings. He and his two sons owned all the stock. It was held that this corporation was a mere agent of *D* and that he was personally liable for the statutory double liability.

In many situations where the courts have felt that the purpose of a statute was being imposed upon, they have not hesitated to look behind the corporate entity.[13] In *United States v. Reading Co.*,[14] a leading case, a holding company was not allowed to control subsidiaries so as to secure freight rebates contrary to statute. In *Northern Securities Co. v. United States*,[15] a holding company was not regarded as an entity separate from its stockholders when the effect was an evasion of the Anti-Trust Act. When all the stockholders of a corporation, acting as individuals, did acts illegal or *ultra vires* which would be ground for forfeiting the charter of the corporation if done by formal corporate action, the court in *People v. North River Sugar Refining Co.*[16] said it would disregard the fiction of corporate entity and treat the action of the stockholders as the action of the corporation, in a proceeding by the state to forfeit the corporate charter. In *First Nat. Bank of Chicago v. Trebein Co.*,[17] where a debtor formed a corporation and transferred all his property to it in fraud of creditors, the court refused to allow incorporation to hinder, delay, or defraud creditors. The principal case, in looking through the corporate entity, would seem to be taking an added step

[9] It would seem clear that the corporation might be validly organized for other purposes and effective as a business unit until it came into conflict with the statute, and yet not stand between its stockholders and a statutory liability.

[10] Where a company, not organized through active fraud, which holds bank stocks also has other assets on which to rely, it would seem to be a question of fact as to just how far a court should require such diversification of interest to go before the assets of the company alone would be held liable for a statutory assessment.

[11] (C. C. A. 6th, 1934) 70 F. (2d) 819.

[12] (C. C. A. 5th, 1931) 53 F. (2d) 190.

[13] Wormser, "Piercing the Veil of Corporate Entity," 12 COL. L. REV. 496 (1912).

[14] 253 U. S. 26, 40 Sup. Ct. 425 (1919).

[15] 193 U. S. 197, 24 Sup. Ct. 436 (1903).

[16] 121 N. Y. 582, 24 N. E. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33 (1890).

[17] 59 Ohio St. 316, 52 N. E. 834 (1898).

in the direction recent cases are tending, rather than making any radical departure.[18]

The second case, growing out of the Detroit Bankers Company relationship, came before the Michigan Supreme Court.[19] It involved the same bank stock set-up. Here the receiver of the Detroit Bankers Company sued its stockholders to recover the assessment for which the company had become liable through the failure of the First National Bank–Detroit, among others. The court allowed recovery on the basis of the stockholders' contractual liability contained in the stock certificates mentioned above. The court proceeds upon the assumption that the primary statutory liability attaches to the holding company,[20] and that in the absence of their contractual liability, the stockholders could not be held for assessment.[21] The corporate entity apparently is regarded as a complete bar; the result in this case would be that the bank receiver would have to recover from the corporate receiver whatever the latter eventually got. In case the holding company had other creditors, there might be a serious question whether they would not be entitled to a pro rata share of the proceeds of this collection. The idea of the court appears to be that the holding company is legally empowered to hold stock in other corporations, and that this is the only test which can be used. The court without discussion states that the statute authorizes such holding.[22] The opinion of the Michigan attorney general,[23] given at the time of the incorporation of the holding company,

[18] 10 N. C. L. REV. 288 (1931-32).

[19] Simons v. Groesbeck, Backus v. Connolly, 268 Mich. 495, 256 N. W. 496 (1934).

[20] Simons v. Groesbeck, Backus v. Connolly, 268 Mich. 495 at 504, 256 N. W. 496 at 499 (1934):

"The liability of the stockholders of the banks here concerned is a primary liability imposed upon stockholders by the statutes of the United States and this State. . . . The holding companies here involved were owners of such bank stock. They were authorized by statute to hold it. . . . The holding companies were each liable to an assessment on that stock as the owners thereof under statutes of the United States and of this State."

[21] Simons v. Groesbeck, Backus v. Connolly, 268 Mich. 495 at 505, 256 N. W. 496 at 500 (1934):

"While it is generally true that the holders of the bankrupt corporate stock are not liable to assessment, yet where the power to make such assessment upon fully paid-up stock is conferred by corporate charter or by the articles of association of the corporation or by a valid statute or by consent of the stockholders or members of the corporation, such liability is enforceable. . . ."

"Stockholders can agree that an assessment can be levied on their stock; they may voluntarily assess themselves for the betterment of the corporation, even though such assessment may have no statutory warrant or authority."

[22] Simons v. Groesbeck, Backus v. Connolly, 268 Mich. 495 at 504, 256 N. W. 496 at 499 (1934).

[23] BIENNIAL REPORT OF ATTORNEY GENERAL, MICH., p. 605 (1929-30).

is interesting in this connection. Although regarding the holding company as a separate entity not engaged in the banking business through owning a controlling interest in banks, he does not say that the incorporation would prevail over the double liability statute.[24] While relying to some extent on the stockholders' contractual liability, the attorney general intimates strongly that he thinks a bank receiver may go directly to the holding company stockholders to collect a statutory assessment.[25] It seems likely that the contractual provision was intended by the incorporators as a protection for the holding company against the burden of a heavy assessment, rather than for the depositors of the constituent banks; and in case it were omitted in other cases, the language of the court seems to indicate that the bank receiver would have no further recourse.[26]

Both on principle and authority the result reached by the federal court seems more desirable. The clear purpose of the statute to provide bank depositors with a reasonable added protection would be nullified if those in control of a bank could turn over their stock to a holding company which might be irresponsible in case an assessment were made.[27] Since the legislature has chosen to impose an added risk on the owners of bank stock in order to give an added protection to bank creditors, should those stockholders be permitted to vitiate that policy and perpetrate at least a constructive fraud upon the statute by use of the corporate device? The trend of authority is far from allowing the benefits of incorporation to be carried to this extent.[28] It has often been said that the corporate concept should be maintained only so far as to

[24] BIENNIAL REPORT OF ATTORNEY GENERAL, MICH., p. 605 at 612 (1929-30): "If the company is uncollectable, the court would probably look through the company to its stockholders and enforce the liability against them."

[25] BIENNIAL REPORT OF ATTORNEY GENERAL, MICH., p. 605 at 612 (1929-30), quoting with approval the language of Chicago, Milwaukee & St. Paul Ry. v. Minneapolis Ass'n, 247 U. S. 490, 38 Sup. Ct. 553 (1918): "In such a case the courts will not permit themselves to be blinded or deceived by mere forms of law, but regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require."

[26] While this explanation of the contractual provision may not be complete, it is a result nevertheless. It may be that the promoters of the holding company wanted to forestall possible objections to the formation of the holding company in Lansing, and also to meet possible public criticism by inserting this provision.

[27] Compare the direct language in Laurent v. Anderson, (C. C. A. 6th, 1934) 70 F. (2d) 819 at 824 (supra, n. 11): "It was not necessary that the [bank] receiver rely upon Banco's [corresponding to the holding company's stockholders here] agreement to pay the double liability."

[28] See Williams v. Cobb, (C. C. A. 2d, 1914) 219 Fed. 663, saying that decisions construing U. S. C. tit. 12, sec. 64, make it clear that the beneficial owner is the one intended by the statute.

reach a desirable result,[29] and when another outcome would be reached, the courts should not hesitate to look to the parties who have set it up.[30] The purpose of the double liability statute would seem to require a direct assessment in favor of the depositors of an insolvent bank rather than to leave the possibility of pro rata allotment from the holding company's assets for such depositors along with all other creditors of the holding company.

T. M. D.

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[29] Wormser, "Piercing the Veil of Corporate Entity," 12 COL. L. REV. 496 (1912).

[30] United States v. Milwaukee Refrigerator Transit Co., (C. C. E. D. Wis. 1905) 142 Fed. 247 at 255: "when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." See also Minifie v. Rowley, 187 Cal. 481, 202 Pac. 673 (1922); Chicago & G. T. Ry. v. Miller, 91 Mich. 166, 51 N. W. 981 (1892). Corpus Juris 59, sec. 20, "it is now well settled, as a general doctrine, that when this [corporate] fiction is urged to an intent not within its reason and purpose, it should be disregarded and the corporation considered as an aggregation of persons, both in equity and at law."