

INSURANCE DEPARTMENT:

✓ Insurance Company, right to reduce capital stock under Section 5915, by surrendering stock and distributing surplus assets.

June 8, 1933.



Mr. Joseph B. Thompson,
Superintendent of Insurance,
Jefferson City, Missouri.

Attention: Mr. James K. Coolidge, Counsel.

Dear Sir:

We are acknowledging receipt of your letter of June 2, 1933, in which you inquire as follows:

"Enclosed are certified copies of the meetings of the stockholders and directors of the American Automobile Fire Insurance Company whereby the capital stock of the company was reduced from \$500,000 to \$300,000. Will you please advise as to whether or not the proceedings thus reducing the capital stock of the company are in conformity with the laws of the State of Missouri and are not violative of the constitution of the United States or of the State of Missouri? We are also enclosing a letter from the attorneys which explains how the reduction is to be handled."

Attached to your letter is a letter from the firm of Bryan, Williams, Cave and McPheeters, counsel for the American Automobile Fire Insurance Company, and resolutions by the directors and stockholders of that company from which we deduce the following facts. The American Automobile Fire Insurance Company is now incorporated for \$500,000, consisting of 5,000 shares at \$100.00 per share par value. The company has a present surplus of \$1,663,630.78. The company seeks to reduce its capital stock from \$500,000 to a capital structure of \$300,000 consisting of 3,000 shares of the par value of \$100.00 each. To that end it is proposed that the company purchase 2,000 shares of its capital stock at \$200.00 per share, and that one-half of the purchase price be paid out of the surplus now on hand. No provision is made for the payment of the other one-half of the purchase price so, consequently, will have to come out of the capital of the company. The board of directors of the company have passed a resolution approving this proposition, and have submitted it to the stockholders of the company who, in turn, have passed a resolution approving this plan of reducing the capital. It appears that all of the stock is held by the American Automobile ~~Fire~~ Insurance Company. You inquire whether the proposed proceedings are in conformity with the laws of this State and in answer thereto we submit the following:

It appears from your correspondence that the company desires to reduce the capital stock to \$300,000 and withdraw \$200,000 of assets from the assets of the company. That being true, it appears that the capital stock of the company must be paid up. We call your attention to this in order that we may determine which section of the Statutes the proceedings must be under. Section 5914 R. S. Mo. 1929, provides that an insurance company incorporated under this State, the capital stock of which has not been fully subscribed, may reduce its capital stock by following a certain procedure. We are assuming from the information before us that the capital stock of this company has been fully subscribed and that, therefore, Section 5914 does not apply, but that Section 5915 will regulate these proceedings. Section 5915 R. S. Mo. 1929, is as follows:

"Any insurance company incorporated under the laws of this state may increase or reduce its capital stock for the purposes, in the manner and to the extent prescribed by law: Provided, the board of directors of any company desiring so to increase or reduce its stock shall file with the superintendent of the insurance department a certified copy of the proceedings, both of the stockholders' and directors' meetings, at which it was determined to increase or reduce such stock, and upon being satisfied that the law has been fully complied with, that the proceedings were regular, that the condition and assets of the company justify the increase or reduction, and that the same will not be prejudicial to the interests of the policyholders, the superintendent shall issue a certificate authorizing said increase or reduction, and showing that the stock of said company has been increased or reduced, the amount to which it is increased or reduced, the par value of the shares; and such certificate shall be filed and recorded as in this chapter is provided for filing and recording the certificates of incorporation; and thereafter such company shall, with such increased or reduced capital, be subject to the same liabilities that it possessed or was subject to at the time of the increase or reduction of its capital; and the charter or certificate of incorporation of such company shall be deemed to be amended in respect to the amount of capital and the par value and number of shares, so as to conform to such increase or reduction."

Section 5924 R. S. Mo. 1929, provides, among other things, as follows:

"No insurance company shall, directly or indirectly, purchase or hold, either absolutely or as collateral, its own stock, after the same has been once issued: Provided, however, that this shall not prevent a company from buy-

ing in its own stock, if the same shall be forfeited and sold to the company for non-payment of assessments thereon, in which case it shall be treated and issued as part of the original stock, " - - - ."

The proceedings contemplated by this company contemplate a purchase by the company of its own stock and provides for the payment for said stock by using part of the surplus and part of the capital of the company. The resolutions adopted by the directors and the stockholders do not in words provide that said capital stock shall be retired and cancelled, although the resolutions might so imply. It is, however, the opinion of this Department that under Section 5924 the company would have no authority to purchase its own stock out of its surplus and capital structure. The section provides that the company shall not "purchase or hold." We do not believe that the word "or" can be construed to mean "and," as the section further provides one instance in which the company may purchase its own stock. The rule generally is that a corporation can not purchase its own capital stock and the reason for the rule is aptly stated in *Chrisman-Sawyer Banking Company v. Independence Manufacturing Company*, 168 Mo. 834, 845, where it is said:

"If the incorporators or stockholders could be allowed, as soon as the incorporation was completed, to sell out their stock to the company, and thereby escape liability for unpaid subscriptions, or in case the stock was fully paid, to receive back from the company the amount paid in, and to turn back to the company the stock subscribed the doors for great frauds upon the creditors would be thrown wide open, and the consequences would not only be disastrous to creditors, but would also be fatal to the corporations themselves, inasmuch as no one would deal with corporations under such conditions."

It is, therefore, our opinion, based upon Section 5924 and the great weight of authority in the United States, that it would be illegal to permit the American Automobile Fire Insurance Company to purchase its own stock by using a portion of its surplus and a portion of its capital.

However, it is the opinion of this Department that the reduction in the capital stock may be legally accomplished with the consent of the board of directors and the stockholders of the company, subject to the approval of the superintendent of insurance, as required in Section 5915. The proper way to reduce the capital structure in our opinion is to have the stockholders surrender and cancel 3,000 shares of the outstanding capital stock, thereby reducing the capital structure to 3,000 shares of \$100.00 par value. After the cancellation of the stock and the reduction of the capital, there may be a distribution of the surplus assets if, as a matter of fact,

there is an excess of surplus assets remaining after the reduction of the capital has been consummated. Such legal proposition is supported by the great weight of authority and is announced in the case of *Benas v. Title Guaranty Trust Company*, 267 S. W. 28, 29, where the St. Louis Court of Appeals says as follows:

"Nor is the rule questioned that a surplus arising from a lawful reduction of the capital stock is available for dividend purposes and may be lawfully distributed as such. (Citations omitted)."

However, the application of the above rule does not mean that because the company reduced its capital stock \$200,000 that it may distribute \$200,000 from its capital structure in all events. It only has the right to make a distribution of the sum equal to the amount of its capital reduction when the actual value of surplus assets equals the amount of the capital reduction. *Benas v. Title Guaranty Trust Company*, 267 S. W. 28. And in arriving at the amount which may be actually distributed in diminution of its capital, actually existing values at the time of the reduction must control and not the values as carried upon the books of the corporation.

In the *Benas* case above it is held, "Books of the corporation and its statement of proceedings for reduction of the capital stock may be contradicted or impeached by parol evidence of the actual values of the assets in determining whether the surplus was sufficient for distribution of dividends without impairing the capital stock as reduced."

In *Fletcher's Encyclopedia of Corporations*, Section 3472, the rule is stated as follows:

"When the amount of capital stock of a corporation is lawfully reduced under Legislative authority, the corporation is not required to keep the excess of its actual capital over the amount of its nominal capital as reduced, nor has any right to do so; but the stockholders have the right to have the excess divided among them, as in the case of a dividend, in proportion to their shares. In making such distribution, however, regard must be had for the present value of the property and the company, instead of distributing money or property equal in value to the excess of the original nominal capital, and the reduced nominal capital must retain property equal in present value to the reduced nominal capital, after deducting its debts. In other words, the surplus, if any, which a corporation may pay to its stockholders on reducing its capital stock, must, in every case, be ascertained, and depends upon the result of an examination into its affairs and not upon

the difference between the original amount of capital stock and the reduced amount. Where a corporation reduces its capital stock and the surplus which thereby results is invested in the stock of railroad corporations, the stock itself may be distributed. It is not essential that the stock be reduced to cash and distributed in that form. Whenever, by sales of property, or by means of earnings, or otherwise, the corporation comes into the possession of funds which are in excess of the amount of its reduced capital stock, it can distribute that amount among the stockholders."

The reason for that rule, of course, is apparent and is that while corporations may have lawful authority to reduce their capital structure, they may not do so at the expense of its creditors, and if, in reducing the capital structure, a sufficient amount of it is withdrawn as would impair the capital as reduced, then the reduction is illegal, and if the reduction of the capital stock and the resulting dividends to the stockholders impairs the capital of the corporation as reduced, then it is a fraud upon the creditors of the corporation and illegal. *Coleman v. Boothe*, 186 S. W. 1021.

Section 5915 provides that the capital reduction may be consummated on obtaining a certificate to that effect from the superintendent of insurance; that the superintendent shall be satisfied that the proceedings are regular and the condition and assets of the company will justify the reduction, and that the reduction will not be prejudicial to the interest of the policyholders. The decision, therefore, as to whether or not the reduction of the capital of this company shall be permitted, depends upon whether the superintendent of insurance is satisfied that the assets of the company will permit such reduction, and that the interest of the policyholders will not be injured by permitting the reduction. In arriving at whether or not the reduction shall be permitted and at the amount of surplus assets which may be distributed, the superintendent shall base his decision upon the present actual value of the assets and not upon the book value, and should satisfy himself that the reduced capital structure has not been impaired by the reduction. It is, therefore, the opinion of this Department that the proposed method of reduction should not be approved for the reason that the corporation seeks to illegally purchase its own stock by using its surplus and its capital, and that it seeks to pay to the stockholders an amount of assets equal in amount to the amount of the capital reduction without regard as to whether a present actual valuation will permit the distribution of that amount of assets.

However, it is the opinion of this Department that the company may lawfully reduce its capital stock by its stockholders surrendering 2,000 shares at \$100.00 par value. If,

Mr. Joseph B. Thompson,

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after the reduction, there exists an excess of assets so that a distribution may be made without the impairment of the capital after the reduction, then such distribution of the excess may lawfully be made. In arriving at the amount which may be distributed, the actual value of the assets should be determined by examination. It does not appear that the proposed reduction in this case would reduce the capital structure below the limit required by the Statute.

In summarizing, it is our opinion that this company may reduce its capital consistent with the views expressed herein, and subject to the requirements of Section 5915, the fulfillment of which requirements is left to the judgment of you as superintendent of Insurance.

Very truly yours,

Assistant Attorney General.

APPROVED:

Attorney General.

FWH:S