CORPORATIONS: A person cannot act as director and vote in a corporation if he has executed his note for capital stock. If the note is executed for treasury stock such person can vote or act as a director.

6-5

May 31, 1934

FILED

Honorable George D. Brownfield
Prosecuting Attorney
Cooper County
Boonville, Missouri

Dear Sir:

This Department acknowledges receipt of your letter of April 23, requesting an opinion. Judging by the facts contained in your letter it does not appear to come within the purview of your duties as prosecuting attorney. Regardless of the same we shall attempt to render you our opinion. Your letter is as follows:

> "The questions have arisen here first, whether or not a person can act as a director in a corporation when he has his stock apothecated to the corporation to secure a note and cannot vote; second, whether or not a note accepted from a stockholder secured by his stock as collateral is allowed under the corporation law. In other words, what we want to know is whether or not it is legal to accept the stock in a corporation as collateral for the security of the payment of a note of a stockholder in same.
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> If you can give me any light on this subject same will be greatly appreciated and I will be glad to reciprocate if the opportunity ever presents itself."

Section 4944 of the Revised Statutes of Missouri 1929, with slight amendment, Laws 1931, page 175, is as follows:

> "No note or obligation given by any stockholder, whether secured by deed of trust, mortgage or otherwise, shall be considered as payment of any part of the capital stock, and no loan of money shall be made by the corporation to any stockholder therein; and if such loan shall be made to a stockholder, the officers making it, or who shall assent thereto, shall be jointly, and severally liable to the corporation for the amount of such loan and interest: Provided,however, that nothing herein shall be construed to prohibit agricultural credit corporations from making loans to farmers who are stockholders therein, such loans to be agricultural or livestock loans to be rediscounted with federal intermediate credit banks in accordance with the federal agricultural credits act of 1923, and amendments thereto."

An interpretation of this section of the statute is given by the court in the decision of Bondurant v. Raven Coal Co. 25 S. W. (2nd) l. c. 575:

> "Our statute provides that no note shall be considered as payment of any part of the corporate stock.Section 10155,R.S.1919. This has reference to payment for stock issued in the first instance. After the corporation has once issued its stock,and the subscriber has paid therefor,the statute is satisfied. A corporation may sell its treasury stock for cash or credit,for par or for market value, or upon any terms that a stockholder could sell.Sherman v.Shaughnessy,148 Mo. App. 679, 129 S.W.245; 14 C.J.407. Nevertheless,we are not willing to say that it affirmatively appears from the pleadings,that plaintiff could not have relied upon the presumption that the purchase price would go into the corporate treasury. We will not trust ourselves to think of every conceivable circumstance which might or might not justify such reliance. The whole circumstances should be developed by the evidence before that question is determined."

By the above decision we find that the statute has been satisfied when cash is paid for the stock in the first instance, and that a corporation may sell its treasury stock for cash or credit. You do not state in your letter the kind of stock hypothecated by the holder of the same, that is,whether or not it is treasury stock or original stock. However,there are recent decisions on the same which we believe by citing to you will enable you to apply the law to the facts in the instant case.

The court said the following in the case of Bankers' Mortgage Co. v. Lessley, 38 S. W. (2d) l. c. 486:

> "The Constitution,as well as the statute, prohibits a corporation from accepting a note in payment for its capital stock. Hunter v. Garanflo,246 Mo. 131,151 S.W.741; Hamilton-Turner Grocery Co. v. Hander (Tex.Civ.App.) 293 S.W.341.
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> If plaintiff could lawfully sell one hundred shares of its stock and accept the defendant's notes, then it could have sold all of its unissued stock and accepted a note or notes therefor.
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> It is claimed that defendant was liable upon the subscription contract, and that the surrender thereof was a consideration for the notes in suit. We do not think so. The subscription contract was not introduced in evidence, nor is there any showing as to its terms. Even if there was, it would not alter the situation. That contract and the original notes were executed at the same time. The subscription contract was not for stock in a corporation to be formed, but,at most,could be nothing more than a subscription for stock in a corporation then existing. The notes were the principal contract, were illegal,and the whole transaction was therefore illegal.
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> If defendant's conduct in executing the notes in suit amounts to a recognition of validity of the original notes, such act amounted to nothing. Parke,Davis & Co. v. Mullett, 245 Mo. 168, 175, 149 S. W. 461.
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> 'And if the contract in fact be only connected with the illegal or immoral transaction and growing out of it,*** it is equally tainted.' Woolfolk v. Duncan, 80 Mo. App. 421, 427."

The principle of law that a corporation can not accept a note for its capital stock is reiterated in the case of Shafer v. Home Trading Co. 52 S. W. (2nd) l. c. 463:

> "The fourth charge relates to the fact that the corporation sold four shares of stock to Martin Blickensderfer for the sum of $200 when the par value of the stock was $400 and took in payment therefor his personal note. While the evidence sustains this charge, plaintiff's own evidence indicates the stock was worth much less than 50 per cent. of its par value at the time it was acquired. The same is true as to charge five relative to stock purchased by Wills Blickensderfer, for which he gave his personal note. The evidence further shows, however, that the corporation illegally acquired the stock sold to Martin and Wills by trading property of the corporation for the stock. A corporation has no authority to trade its property in purchase of its outstanding stock, the effect of which is to illegally reduce its capital. Potts-Turnbull Advertising Company v. Gatchell (Mo. Sup.) 257 S. W. 134, loc. cit. 139, St. Louis Carriage Manufacturing Co. v. Hilbert, 24 Mo. App. 338. Moreover, granting that it had legally acquired the stock, it is prohibited from accepting a note in payment of its capital stock. Bankers' Mortgage Co. v. Lessley, 225 Mo. App. 643, 38 S.W. (2d) 485, loc. cit. 486. The fourth and fifth charges in plaintiff's petition must therefore be sustained. The sixth charge, relative to illegal purchase of stock by the corporation, is also sustained under the above ruling."

CONCLUSION

We are of the opinion that if the director in question gave his note and hypothecated his stock for the capital stock of the corporation he can not act as a director nor vote.

If, however, it is treasury stock for which he has collaterated his note with the stock, it will appear from the decisions that he would not be precluded from voting or acting as a director.

Yours very truly,

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APPROVED:

ROY McKITTRICK
Attorney General.

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