BANKS & BANKING: Constitutionality of House Bill No. 92, Senate Bill No. 43, Extra Session - Capital notes issued by bank or trust company.

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Hon. O. H. Moberly
Commissioner of Finance
Jefferson City, Missouri

Dear Mr. Moberly:

This office is in receipt of your letter of November 9th, 1933, with request for an opinion of this Department as to the validity and constitutionality of House Bill No. 92 lately introduced in the Legislature. Your letter of request is as follows:

> "I beg to hand you herewith copy of the above numbered House Bill. You will notice it provides for Missouri banks and trust companies, through authority of their boards of directors, to issue capital notes.
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> I would appreciate your opinion, as quickly as possible, concerning this Bill and especially your opinion with reference to whether or not it conflicts with Section 8 of Article 12 of Missouri Constitution.
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> If the capital notes proposed to be issued are not bonds or bonded indebtedness within the meaning of the Constitution, then it seems to me the legislation as proposed would be valid and the securities as offered would be within the constitutional provision."

I.

It is proposed under this bill to repeal Sections 5312, 5313, 5314 and 5315, R. S. Mo. 1929, and to enact four new sections in lieu thereof carrying the same numbers, which has

for its purpose to grant authority to a state bank or trust company, by authority of its board of directors, to issue and sell its capital notes at not less than par for the purpose of rehabilitating and taking care of impairments of the capital of banks and trust companies. Your letter calls for a construction of the proposed legislation and may be divided into two questions:

(1) Is the bill in harmony with the laws of Missouri?

(2) Especially is it in harmoney with Section 8, Article XII, of the Constitution of Missouri?

(1) The proposed legislation, in our opinion, is in harmony with the general laws of Missouri and if enacted will empower a state bank or trust company, through its board of directors, to issue and sell its capital notes for the purposes and in the manner provided by the proposed bill.

(2) On the second proposition you desire to know whether or not the bill, if enacted, would in any way contravene the provisions of Section 8, Article XII, of the Constitution of Missouri, especially that part of the Constitution which provides (a) for a corporation to issue bonds; and (b) whether or not it is necessary to have a vote of the stockholders to issue the capital notes provided in the proposed bill.

We beg to advise it is our opinion that the proposed bill will not in anywise run counter to the requirements of Section 8, Article XII, of the Constitution of Missouri, or any other provision of the Constitution.

Section 8, Article XII, of the Missouri Constitution, reads as follows:

> "No corporation shall issue stock or bonds, except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased, except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained at a meeting called for the purpose, first giving sixty days' public notice, as may be provided by law."

The above section is divided into two sentences, the first of which, in our opinion, is mandatory and provides that the corporation can not issue stock or bonds except for money paid, labor done, or property actually received, and all fictitious increase of stock of indebtedness shall be void. In other words, the corporation must receive full value for the stock or bonds issued whether it be in money, labor done, or property, and all fictitious increase of stock or indebtedness shall be void.

In the second sentence of this constitutional provision the same word "stock" is used but the word "bonds" as used in the first sentence is changed to the words "bonded indebtedness". It is our opinion that the words "bonded indebtedness" are included in the word "bond" and mean the accumulated indebtedness of the corporation which is represented by "bonds". Under all of the cases in which this question has come to appellate court as to what are "bonds" and what represents "bonded indebtedness" has come up in connection with business corporations organized under the sections of the law pertaining to business manufacturing corporations and usually a mortgage securing the bonds was authorized.

The above provision of the Constitution is the fundamental law of our State relative to the issuing of stock and bonds by corporations and came into our Constitution in 1875, and we do not find that it appeared in any prior Constitution of Missouri. To throw light on the meaning of the words "bond" and "bonded indebtedness" at the time these words were placed in the Missouri Constitution in 1875 we must look to the meaning of same as interpreted by the courts before and at the time of their use in the Constitution and we must assume that these words were therein used in the sense and the interpretation these terms had been given by our courts at that time.

In the case of Cartmill v. Hopkins, 2 Mo. 220, the question discussed was whether the instrument sued on was a note or a bond.

In the case of Glasscock v. Glasscock & Dodd, 8 Mo. 577 (1844), the same question was involved as to whether the instrument was a note or a bond, in which, quoting from the syllabus of this case, it is said:

> "An instrument of writing will not be considered as sealed unless by some expression

> in the body of the instrument; the maker should show that he intended it to be considered as a specialty. A mere scrawl at the end of the name, with the word 'seal' within it, will not make the writing a bond."

Grimsley v. Riley, 5 Mo. 165, is to the same effect.

The question is discussed in the case of State ex rel. West v. Thompson et al, 49 Mo. 188, l. c. 189:

> "'The common law intended by a seal an impression upon wax or wafer, or some other tenacious substance capable of being impressed.' (4 Kent, 452.) We have been very liberal as to what constitutes a common-law seal (Pease v. Lawson, 33 Mo. 35; Turner v. Field, 44 Mo. 382), but have never dispensed with a seal in bonds and deeds, only as the statute substitutes a scrawl in lieu thereof. It might be very well, as has been done in some States, to dispense with seals altogether, but courts cannot so change the law, and those who desire the change must look to the law-making power."

The word "bond" had a definite meaning at the time it was used in the Constitution of 1875 as defined by the courts prior to that time and under the well known rule that it was used in the Constitution with the same meaning as it was interpreted by the courts at that time. When the word "bond" was used in the above section of the Constitution of 1875 it meant an instrument executed by the formalities required by the common law, that the actual common law seal would be permitted provided the executed instrument would contain a recitation of the maker of the instrument to substitute a scrawl or other symbol of a seal and the substitution should be shown by the instrument to be required in lieu of the seal, or as a seal.

Section 11, Article XII, of the Constitution of the State of California prior to 1926 was identically the same as Section 8, Article XII, of the Missouri Constitution, and the Supreme Court

of California in construing the term "bonded indebtedness", as used in the Constitution of that State, said:

> "The Supreme Court of this state in the case of Underhill v. Santa Barbara etc. Co., 93 Cal. 300, 28 Pac. 1049, in construing the term 'bonded indebtedness' as found in section 11 of article 12 of the Constitution having reference to the obligations of private corporations, has held that a note and mortgage issued by such a corporation is not a bonded indebtedness within the meaning of said provision of the Constitution. To hold otherwise would be to extend the language of the Constitution to practically every form of indebtedness which a private corporation could create, and to require in every case the consent of its stockholders to the creation of such indebtedness and to the issuance of the writing which would evidence the same."
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> Bank of Newman v. Monterey County Gas & Electric Co., 191 Pac. 970.

The words "capital notes" proposed to be issued by the above act is in our opinion not within the definition of a "bond" contained in the Constitution as interpreted by our Supreme Court prior to the adoption of the constitutional provision referred to and the definition of the word "bond" as interpreted by our appellate courts since 1875 has not changed its meaning, and the word "bond" as used in the above section means a special instrument of writing which the common law required to be under seal whether the instrument was executed by an individual or a corporation.

II.

The power and authority of a bank to borrow money for the purpose of carrying on its banking business has not been questioned in this State. In one of the earlier cases on the subject, in the case of Ringling v. Kohn, 6 Mo. App. 333, l. c. 335 and 337, the court said:

> "The charter gave to the corporation general banking powers in terms such as are usually employed for that purpose. Sess. Acts 1857, p. 642, sect. 6. Nothing is said about borrowing money. But it is elementary law that a corporation may exercise any unforbidden power which is necessary to carry into effect the powers specially granted. It would be a strange limitation of the authority to purchase exchanges, or to loan money, which should deny a simple means of obtaining occasional supplies for the purpose. A specific authority to borrow money rarely, if ever, appears in any bank charter. It has always been esteemed a necessary and inherent privilege, inseparable from the exercise of banking functions. Without it no bank, however ample its assets, could at times avoid insolvency. Curtis v. Leavitt, 15 N. Y. 9."

> "In Barnes v. Ontario Bank, 19 N. Y. 156, the court said: 'That the power to borrow existed was determined by this court in the case of Curtis v. Leavitt. That the cashier, in virtue of his general employment, could exercise the power was not denied upon the argument, and the proposition does not admit of a reasonable doubt.'
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> Said Story, J., in Fleckner v. United States Bank, 8 Wheat. 357: 'The acts of the cashier, done in the ordinary course of the business actually confided to such an officer, may well be deemed prima facie evidence that they fell within the scope of his duty.'"

The above case was cited approvingly in the case of Donnell v. Lewis County Savings Bank, 80 Mo. 165.

Michie on Banks and Banking, Vol. 4, page 133, has this to say on the power of a cashier to borrow money for the bank:

> "The cashier of a bank is the proper officer to execute its power of borrowing money and he needs no special delegation of authority to do

> so. If done in the ordinary course of its business, it is presumably done within the scope of his duty and the bank is bound by his acts and representation in the apparent exercise of such authority."

In the proposed bill under consideration action to borrow the money is first taken and approved by the board of directors. Of course, the board of directors has more authority and power to borrow money than the cashier alone.

III.

The Supreme Court of this State has recognized the doctrine of estoppel where a corporation has borrowed money or secured some benefit from the contract although the same has been entered into informally, and this doctrine was recognized by the court in the case of Coerver v. Crescent Lead and Zinc Co., 315 Mo. 276, l. c. 297, and in the case of Farmers and Traders Bank v. Harrison et al, 321 Mo. 815, and at page 823 the Supreme Court touched on the phase of the case in the following language:

> "Whether there is implied power in a bank to secure a mere general depositor is a question that appears never to have been determined in this State. The point was raised but not decided in Cantley v. Little River Drainage Dist., supra, 2 S. W. (2d) l. c. 611, and in Huntsville Trust Co. v. Noel, ante, 749; and it is not open for decision here, because the appellant pleaded estoppel and the evidence tends to show the Auxvasse Bank got at least much the greater part of the money in controversy and held all of it on faith of the bond. The contract was performed by appellant. In these circumstances the defense of ultra vires is not available. (Cantley v. Little River Drainage Dist., supra, 2 S. W. (2d) l. c. 612.)"

In the bill under consideration, in the event the capital notes provided for therein were issued by the bank and it received the par value of the same in cash as provided by the bill, is the corporation or any of its stockholders in a position to question the validity of same?

The Supreme Court said in Cantley v. Little River Drainage District, 2 S. W. (2d) 607, l. c. 612:

> "However, there is another theory of the law which just as effectively disposes of the case. That the bank got the benefit of the funds of the drainage district is uncontroverted. The contract was fully executed by the drainage district, and in such case, ultra vires, even if pleaded, cannot be successfully invoked. McCormick v. Bank, 304 Mo. loc. cit. 288, 289, 263 S. W. 152; Schlitz Brewing Co. v. Poultry & Game Co., 287 Mo. loc. cit. 407, 229 S. W. 813; Hanlon Millinery Co. v. Trust Co., 251 Mo. 579, 158 S. W. 359; National Bank of Commerce v. Francis, 296 Mo. loc. cit. 195 and 196, 246 S. W. 326.
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> In the Schlitz Brewing Co. Case, supra, J. T. Blair, J., has fully collected the authorities and says:
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> 'With respect to estoppel to plead ultra vires to a contract fully executed on one side defendants rely upon the federal rule, in the main. This court and the courts of appeals of this state long since adopted the rule in force in most of the states which we said in Millinery Co. v. Trust Co., 251 Mo. loc. cit. 579 (158 S. W. 359), had been tersely stated by Rombauer, P. J., in Winscott v. Inv. Co., 63 Mo. App. loc. cit. 369, to be that: "the defense of ultra vires is not admissible where the contract has been fully executed on one side, unless it is a contract expressly prohibited by law."'"

The court in the case of Merchants' Ice and Fuel Company v. Holland Banking Company, 8 S. W. (2d) 1030, l. c. 1034, had this to say:

> "There is no better authority on that question than Bank v. Lyons, supra, In that case the Supreme Court was considering the right of the lender of money to a bank to recover in assumpsit for money had and received, although the action of the bank's cashier in making

the bank's note and in hypothecating other notes of the bank as security for the money borrowed, was void under the statute. The Supreme Court in banc held the bank was liable, and in the course of the opinion uses this language (220 Mo. loc. cit. 556, 119 S. W. 544):

> 'If it (the bank) repudiates the note for the reason that the Board of Directors had not authorized its execution, then this court would sanction rank injustice to hold that payment of that money need not be made at all. Such is not the law. The bank was not exempt from the common obligation to do justice which binds individuals. Such obligations rest upon all persons whether natural or artificial. If the bank obtained the money and by mistake or without authority of law executed therefor an invalid note, then it was its duty under this general obligation to do justice, to refund it. Under those conditions an implied obligation arose on the part of the appellant to repay the money so obtained.'"

IV.

In conclusion, it is our opinion that there is no reasonable doubt as to the status of the proposed capital notes under the proposed act when issued by a Missouri bank or trust company and sold for full value as required by the act. Capital notes issued thereunder are junior obligations of the bank compared to obligations to depositors and general creditors. They are only superior to the obligations to the stockholders and then only as to the payment of dividends. And then, such bank or trust company must agree upon restriction upon the distribution or payment of dividends upon its capital stock by the board of directors. So then who is left to question the validity of the capital notes?

The general creditors and depositors are not injured and could not question the validity of the capital notes or the power of the bank or trust company to issue them for the reason that they have been benefited by the issuance of the capital notes and not injured, and their validity could not be attacked collaterally and no persons could be heard to question their validity unless it be the stockholders of the issuing bank or trust company. And if their bank or trust company has received full value for the capital notes are not the stockholders estopped from questioning their validity? Their bank having received full consideration for the notes has received full value and so far as the holders of the capital notes are concerned their part of the contract would have been fully executed. The stockholder would have received his pro rata portion of such money by reason of the fact of owning stock in the issuing bank or trust company. In any event, the claim of the noteholders for money had and received against the bank or trust company would be superior to the stockholders of the issuing bank or trust company. Any complaint made by the stockholder as to the transaction would be unavailing.

It is, therefore, our opinion that the bill as proposed would vest in the board of directors of the bank or trust company the power to issue the capital notes for the uses and purposes and under the conditions as provided in the bill and that said bill does not contravene the provisions of Section 8, Article XII, of the Constitution of Missouri, and is in harmony with the general law of Missouri.

Very truly yours,

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Assistant Attorney-General.

APPROVED:

ROY McKITTRICK
Attorney-General.

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