BANKING CORPORATIONS - restoration of impaired capital.

: Under the order of the Commissioner of Finance for a banking corporation to restore impaired capital, the directors of such corporation may personally sign a guaranty or place property in escrow with a contract that such property may be held by the Commissioner of Finance, or other person designated, until the capital impairment of such corporation is restored from normal earnings or if need be, to sell such assets and apply the proceeds to such repairment. Such contract should be definite respecting the rights of all parties as to the holding, sale or withdrawal of such property.

February 9, 1946

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Honorable M. E. Morris
Commissioner of Finance
Jefferson City, Missouri

Dear Mr. Morris:

We have your letter requesting an opinion respecting the right and the binding effect, in case of the impairment of the capital funds of a bank, of the Directors of a bank to restore the impaired capital stock to personally sign a guaranty, or place cash and United States Government Bonds, belonging to them personally in escrow, with a contract providing that such guaranty, or cash and bonds, as the case may be, shall be held until such time as the capital impairment is restored from normal earnings. Your letter requesting the opinion is as follows:

> "Under authority of Section 7904, R.S. Mo. 1939, I recently issued an order directing that the capital stock of a corporation, which in my opinion has an impairment, be restored by a certain date.
>
> "The Directors of this corporation have offered to personally sign a guaranty or place cash and United States government bonds, belonging to them personally, in escrow with a contract that they shall be held until such time that the capital impairment is restored from normal earnings. Should the bank fail, these securities or cash would be forfeited and used in paying the deposit liability of the bank. They suggest that they are willing to enter into any type of contract which we prepare in this connection.
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> "Please advise if there is any legal authority for such procedure and oblige."

We observe by your letter that you have made your departmental order for the bank in question whose capital has

become impaired, to restore the impaired capital stock within a time specified in your order, under Section 7904, Article 1, Chapter 39, R.S. Mo. 1939. Paragraph (1) of said Section 7904, giving you this power is as follows:

> "(1) Whenever the commissioner shall have reason to believe that the capital stock of any corporation subject to the provisions of this chapter is reduced by impairment or otherwise, below the amount required by law, or by its certificates or articles of association, he shall issue an order that such corporation make good the deficiency forthwith or within a time specified in such order."

Section 7906, Article 1, Chapter 39, R.S. Mo. 1939, points out the procedure for Directors of a bank to follow in restoring impaired capital stock of a bank by issuing and selling capital notes. That method of restoring impaired capital stock of the bank in question is not involved here but it is not exclusive. Neither said Section 7906, nor any other Section of said Article and Chapter prohibits or in anywise abridges the right of Directors, stockholders, or officers of a bank to make donations, contracts, or the pledging of property to said bank, the use of any other lawful method to fully accomplish the restoration of the capital stock or capital funds of a bank where such capital stock has become impaired.

The duty resting upon the stockholders to keep the capital stock of a bank unimpaired is treated in C.J.S., Volume 9, Section 60, page 91, under "Banks and Banking". Said Section, in part, is as follows:

> "The capital stock of a bank is a trust fund for the benefit of depositors and creditors and must be kept unimpaired, and the duty of making good on impairment rests on the stockholders. When the supervising officer of banks finds an impairment of capital of a banking institution, he may direct that the impairment be restored or made good within a certain time as a condition for continuance in business, and he may make an agreement with the officers of the bank whereby securities are pledged with him to secure the impairment; * * * ".

The same work, 9 C.J.S., pages 92 and 93, on this subject states this further text:

> "Property conveyed by a stockholder to a bank to improve its assets is conveyed for a consideration, and becomes an asset of the bank.
>
> "Where the directors of a bank, in response to a demand of the state bank examiner that they make good an impairment of the capital stock, sign and discount their personal note and deposit the proceeds to the credit of the bank, the transaction is a donation or gift to the bank.

The St. Louis Court of Appeals in this State considered in the case of Farmers & Merchants Bank of Eureka vs. Boland, the question of the liability of a person who had executed and delivered to the bank his promissory note for the purpose of providing for the restoration of impaired capital funds of the bank. The case is reported in 175 S. W. (2d) 939. The facts briefly stated were that Boland, a director in the bank, along with the other directors, provided funds for the restoration of the impaired capital funds of the bank. Boland gave his note to the bank for $1000 for a loan of that amount in cash. The directors of the bank approved his loan. The proceeds of the note in cash were deposited to Mr. Boland's account. There it remained undisturbed until it was used some time later for the repairment of the impaired funds of the bank. The original impairment of the surplus and funds of the bank was a depreciation in its bond account. Later, the bond account was revived and restored by the reestablishment and appreciation of the bonds that had formerly been depreciated, and Mr. Boland received his $1000 back from that source in 1935 or 1936. Mr. Boland from time to time renewed the note by giving a new note, and for a time paid the accumulated interest on each note. Later, he failed and refused to execute a new note upon the expiration of the due date period of the immediate former one and refused to pay the interest. The bank after demand, sued Boland upon the note. The bank recovered in the lower court. Boland appealed to the St. Louis Court of Appeals.

The defense of Mr. Boland was that at the time the suit was filed for some time before the impaired capital funds of the bank had been restored in the regular course of its business transactions, and that there was no consideration for the note, and that the note was not a gift to the bank, and that because

of the conditions under which the note was given, he had the right to withdraw the note without paying the same.

The St. Louis Court of Appeals in affirming the judgment of the lower court in favor of the bank and against Boland, and holding that money advanced by members of a Board of Directors in order to restore the capital or surplus of the bank was a gift to the bank, and could not be withdrawn even after the capital and surplus of the bank had been restored, unless and until the Commissioner of Finance gave his consent for such withdrawal where an agreement specified that the Commissioner of Finance must give his consent for the withdrawal -- and in the Boland case he had not done so -- the St. Louis Court of Appeals, l.c. 946, 947, said:

> "Under Sections 7904 and 7910, R.S. Mo. 1939, Mo. R.S.A. Secs. 7904 and 7910, the state's Commissioner of Finance has very broad powers which he, in his discretion, may exercise for the protection of banks and for the safety and security of their depositors and creditors. He has power to require a bank's directors to do many things to safeguard a bank's funds and, under certain circumstances set forth in the statutes, supra, to close a bank and to take possession of its assets.
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> *
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> "We are of the opinion that defendant failed to sustain his affirmative defense to the note sued on and was not entitled to have it canceled or to be relieved of payment thereof. * * * ".

The above case furnishes ample authority for the exercise of the broad powers given the Commissioner of Finance under the statute. The Courts of other States have held to the same ruling as our Court of Appeals in the Boland case. Such authorities are cited in the footnotes to the above quoted authority of C.J.S., and may be readily available for further research upon the question by those interested. They are not further noted here because the decision of our own Court above quoted is sufficient, we think.

We believe, however, that if such a contract as mentioned in the letter of the Commissioner of Finance be entered into as a guaranty, or pledging property or for the placing of cash or bonds or other property in escrow for the purpose of restoring impaired capital stock, funds or surplus of a bank, it should be definite and positive in providing that the bank or other proper person, the Commissioner of Finance if he be agreed upon, have the absolute right to hold such assets for a definite time until the capital stock, funds or surplus of the bank be restored from normal earnings, or that if, at any time during the existence of such impairment, it may become necessary or expedient to use such pledged cash or securities, or other property, provided for the purpose, that the same be held to be a gift to the bank, and that the same may be sold and the proceeds thereof, or the cash, if such pledged assets be in cash, be applied to the restoration of such impaired capital stock, and that the conditions under which the Directors, stockholders or officers of the bank may with draw such assets be set forth in plain, definite, language so that there may be no controversy about the matter.

Our Supreme Court considered a case somewhat of the nature of the question here being considered in the case of State ex rel. Gordon vs. Trimble et al. 318 Mo. 341. The Supreme Court held in the Gordon case that it was not every payment of assessments or pledged assets by directors or stockholders of a bank to restore the impaired capital stock or funds of a bank that became a gift to the bank. The Court held that whether such pledged assets became a gift or were a loan, and should be repaid by the bank to the persons providing the same, should be stated definitely in the agreement providing for the assessment or pledging of assets to relieve a bank of financial difficulties. The Court, l.c. 346, 347, on the point, said:

> "The cases cited by respondents undoubtedly support the general proposition that 'where stockholders voluntarily assessed themselves to relieve the corporation from pecuniary embarrassment; or for the betterment of their stock, such advancements are not debts, but assets of the corporation.' But it does not follow that every payment of money to a financially embarrassed corporation by one or all of its stockholders or directors is paid to it without any agreement for its repayment or that a stockholder cannot make a payment under such an agreement which may be recovered.

* *

> "Even if the payments of assessments by stockholders and directors to a corporation to relieve its financial embarrassment, without the showing of an agreement to the contrary, must be regarded as assets of the corporation and not as debts, it does not follow that such payments may not be made under a valid and binding agreement that they are to constitute debts of the corporation which should be repaid. * * * "

The Supreme Court held in the Gordon case that the director and president of a bank was entitled to withdraw the funds he had provided for the restoration of the impaired capital funds of the bank on the ground that the contract and agreement made when the funds were provided for did not specifically state that he was not entitled to withdraw them, and did not state definitely that they were a gift to the bank there being evidence of a verbal understanding that he was to be repaid. Following that decision we think as stated above that this should be definitely stated in the agreement and contract providing for such pledging of property.

It is a familiar rule of the common law that any person has the right to engage in any business, undertaking or contract which is not evil or unlawful in itself, unless of course, such acts are prohibited by statute. We believe that any person interested in a bank as a stockholder, director, or officer would have the right under the above cited authorities to enter into such a contract as is mentioned in your letter, or to pledge securities or assets of any kind including cash, or Government bonds, to restore the impaired capital stock of a bank.

CONCLUSION.

It is, therefore, the opinion of this Department that directors or stockholders of the banking institution referred to in your letter may lawfully, personally sign a guaranty, or pledge cash or United States Government bonds to a bank, and place them in escrow to be held by the Commissioner of Finance or the bank, or any person or corporation named in a contract provided that it may be held until such time as the

capital impairment is restored, or be sold if necessary to restore such impairment. Such a contract would be lawful under the above cited authorities. Such a contract, however, should be definite and certain as to the rights of all the parties concerned respecting the holding, sale or withdrawal of such pledged assets.

Respectfully submitted,

GEORGE W. CROWLEY
Assistant Attorney General

APPROVED:

J. E. TAYLOR
Attorney General

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