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LIABILITY OF STOCKHOLDERS UNDER THE INDIANA BANKING LAW

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The increasing number of bank liquidations due in part to the economic readjustment following the World War, has given rise to important questions of banking law. These questions are of great importance to the legal profession and to the public, and in view of the vast interests involved, and of the capital invested, it is a matter of surprise to find the scarcity of judicial interpretation of Indiana Banking Statutes, and especially those pertaining to the liability assumed by stockholders.

Sec. 6 of Article 12 of the State Constitution provides: "The stockholders of every bank or banking company shall be individually responsible to an amount, over and above their stock, equal to their respective shares of stock, for all debts or liabilities of said bank or banking company."

Sec. 3858, Burns' Rev. Statutes, 1926, being the Discount and Deposit banking law, provides: "The shareholders of each bank or association formed under the provisions of this act shall be individually liable to an assessment of not to exceed one hundred percent. of the par value of their respective shares of capital stock, and in addition to all assessments for unpaid subscriptions for capital stock or parts thereof, same to be levied and collected as hereinafter provided, when such assessment is required for the payment of the debts or liabilities of such bank or association or to restore the capital stock thereof."

Section 3858 further provides for notice to stock-holders in case of impairment, and the procedure is set forth leading up to the assessment by the bank directors, and providing for its collection. Among other things, it provides that if any stockholder should fail to pay any assessment so levied, his stock may be sold after appraisement and notice and the proceeds of such sale applied by the directors as follows:

First, to the payment of costs of sale.

Second, to the payment or reduction of any amount assessed and unpaid on any outstanding capital stock, to make good such impairment of capital stock.

Third, to the payment or reduction of any amount due thereon for unpaid subscription for such capital stock.

Fourth, any residue remaining after paying the amounts aforesaid shall be paid at once to the owner of such stock.

A review of the early constitutional and statutory provisions may be helpful.

The constitution of 1816 contained no provision fixing liability of stockholders in banks, and the constitution of 1851 contained the provision for double liability as is set out earlier in this article.

Section 25 of Chapter 12 of Acts of 1855 provided that "Every shareholder of any such association shall be liable in his individual capacity for any contract, debt, or engagement of such association, to an amount over and above his stock, equal to the amount of his shares of such stock."[1]

In the Acts of 1873, it was provided that "The shareholders of each association formed under the provisions of this act, shall be held individually responsible for all contracts, debts, and engagements of such association, made, contracted or incurred during the time such persons were the owners of a portion of the stock of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares."[2]

In 1895 the 1873 law was amended so as to provide that shareholders should be individually responsible to an amount over and above their stock, equal to the par value thereof for all debts or liabilities of the association to be collected by suit and also as therein provided.

It is further provided that if the Auditor of State discovers an impairment in the capital stock of any bank, he could require an assessment after notice, and if not paid by the stockholders, the stock could be sold, and the expenses of sale deducted therefrom.[3]

This section was again amended in 1919 and additional provisions were made for the use of funds derived from sale of stock for payment of assessment which section is set out earlier in this article.[4]

It was held at an early date that the liability provided by Article 12 of the State Constitution was for the benefit of the creditors of the bank, and the court also held that a stockholder who is also a creditor of the bank cannot set off its indebtedness to him, against his constitutional liability for its debts.[5]

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1 1Gavin and Hord, page 130.

2 Davis Rev. Statutes of Indiana, Vol. 1, page 165.

3 See Acts 1895, page 203.

4 Acts 1919, page 832, Sec. 3858, Burns' Rev. Stat. 1926.

5 *Gentry v. Alexander, President of the Bank of Gosport,* 16 Ind. 471.

In another case[6] the Supreme Court in construing Sec. 2696 Rev. Statutes 1881, which provides that stockholders shall be individually responsible for all debts to the extent of the amount of their stock, in addition to the amount invested, held that such liability is created exclusively for the benefit of the corporate creditors. That it is not to be numbered among the assets of the corporation, and the corporation has no right or interest in it, and that the corporation or its receiver could not collect it. The court, in its opinion, quotes as follows from Thompson on Corporations: "It may be stated, as a general rule, that statutes making stockholders individually liable to creditors, independently of what they owe the corporation on account of their stock, create a right following directly from the stockholders to creditors. The sums thus secured to creditors form no part of the assets of the company, but are a supplemental or superadded security for the benefit of creditors. . . . No action to enforce such liability can be brought by a receiver or assignee of the corporation; such an action must be brought by one or more of the creditors."[7]

Section 3858, Burns' Rev. Statutes 1926, prior to its amendment in 1919, was before the Appellate Court for consideration in the case of Citizens State Bank of Perisho.[8] It was there held that the proceeds derived from the sale of the stock of a stockholder who had failed to pay his assessment made for an impairment of capital stock, belonged to the stockholder, after the payment of the costs of the proceedings, and were not part of the assets of the bank. The court quoted from a federal decision envolving the Indiana law, as follows: "The purpose of the statute is apparently to enable the bank to get rid of unwilling stockholders and to go on with its business. The extra obligations of shareholders for debts and liabilities of the corporations in default of assets is fully provided for in other portions of the statute. No obligation of that sort is involved here. The statute does not in terms or by necessary implication create any obligation on stockholders to pay more than full par value of the shares merely to replenish or replace capital lost in the business of the corporation."[9]

That section 3858 and similar sections of former statutes have

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[6] *Runner, Assignee v. Dwiggins*, 147 Ind. 238.

[7] See, however, Act 1915, Sec. 687, passed since the above decision and which provides that a receiver may collect a liability of a stockholder.

[8] 77 App. 70.

[9] See, also, *Chicago Title & Trust Co. v. State Bank*, 86 Fed. 863; 121 Fed. 58.

been variously construed by bankers is shown by the passage of section 3859, Burns' Rev. Statutes, 1926, Acts 1919, page 832, which legalizes sales of stock heretofore made or assessments collected, which had been made in substantial compliance with that and former statutes.

There seems to be a widespread opinion among bankers that payment of a one hundred per cent. assessment for impairment of capital stock would relieve the stockholders from another one hundred per cent. assessment for payment of debts under the constitution. This question does not seem to have been passed upon directly by our higher courts and is one of great importance.

In a consideration of this question, it must be kept in mind that there are two distinct principles applicable to the business of banking; sound operations and sound liquidations at the close of operations. Assessment of stock to make good impairment of capital relates solely to operation. Assessment of stock for the payment of debts relates solely to liquidations.

This question was recently before the Supreme Court of South Dakota.[10] The suit was brought by the State Superintendent of Banks against appellant, who was a stockholder in an insolvent bank, to collect a one hundred per cent. liability under Sec. 3, Art. 18 of the Constitution of South Dakota. The defense interposed was that appellant stockholder had already paid an assessment of one hundred per cent. levied to take care of an impairment of capital stock and could not be further proceeded against.

In upholding the constitutional liability, notwithstanding the prior assessment, the court said: "We are of the opinion that the voluntary payment of the one hundred per cent. stock assessment by respondent in 1921 constitutes no defense to this action. The present action is to enforce a liability, which under our constitution and statute is a personal liability and is for the benefit of creditors. The bank itself, or its directors, had no authority over such liability and could neither collect it nor release it. The previous one hundred per cent. assessment was not a personal liability of respondent, but was merely against the stock. It was not for the benefit of creditors, but for the benefit of the bank as a going concern, and, consequently, for the benefit of stockholders themselves. If respondent had not paid that assessment, she would not have been under personal liability by reason thereof, but her stock might have been taken and sold. When respondent saw fit to pay such assessment, it

[10] *Smith v. Goldsmith* (S. D.), 207 N. W. 977.

amounted to nothing more than a further voluntary investment in the capital stock of the corporation paid into the general fund of the corporation, not for payment over to creditors, but for the benefit of the corporation and the stockholders thereof, including, respondent, and the payment of that assessment had no connection with the liability now sought to be enforced and is no defense in the present action."

In a recent Texas case[11] the same question was involved, with the further claim by the stockholder that he be allowed to set off an amount paid on an assessment to meet an impairment of capital against his double liability to creditors. The court in upholding the assessment, said: "The constitutional liability of stockholders in banking corporations was designed wholly for the benefit of creditors, and constitutes a fund available only when the bank is insolvent and unable to meet its obligations in full. The purpose of the former assessment was not to benefit creditors, because the bank was then a going concern, but was only for the purpose of repairing its impaired capital and was a benefit to the corporation and to the stockholders only . . . . We think the law is well settled that payments made for the purpose of restoring the impaired capital of a bank cannot be offset against an assessment of the stockholders of an insolvent bank, for the purpose of discharging its indebtedness in the course of liquidation, (citing cases) . . . . The obligations of stockholders under the several articles are entirely diverse, and payments made under the one cannot be applied to the satisfaction of undivided responsibility secured under the other."

In the year 1926 the question was before the Supreme Court of Kansas[12] and the syllabus reads as follows: "Payments made by stockholders to a bank in consequence of impairment of capital, with purpose or effect to repair breach in capital or to keep the bank a going concern, are voluntary payments, however induced, and have no effect to discharge double liability. Assessments of bank stock to make good impairment of capital and double liability of stockholders subserve entirely distinct and wholly different purposes. One is an incident of operation; the other is an incident of liquidation."

The Federal Courts have reached the same conclusion with reference to analogous statutes. The leading case is *Delano v.*

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[11] *Markus v. Austin* (Tex. Civ. App.), 284 S. W. 326, followed in *Ragland v. Austin* (Tex. Civ. App.), 284 S. W. 330.

[12] *Citizens Bank of Lane, etc. v. Needham,* 120 Kn. 523, 244 Pac. 7, 45 A. L. R. 1202.

Butler.[13] In that case there was an attempt to apply the payment of an assessment to take care of impaired capital as against the Statutory double liability for debts. In deciding the case, the Supreme Court of the United States said: "The assessment imposed upon the stockholders by their own vote, for the purpose of restoring their lost capital, as a consideration for the privilege of continuing business, and to avoid liquidation, is not the assessment contemplated by statute by which the share holders of every national banking association may be compelled to discharge their individual responsibility for the contracts, debts and engagements of the association. . . . . If the claim in the present case be allowed, it would follow that in every case payments made by stockholders, for the purpose of restoring the impaired capital, would be considered as credits on the ultimate individual responsibility of shareholders, and the whole efficiency of the provisions of said sections for the protection of the creditors of the company at the time of liquidation would be destroyed."

It is interesting to note that in Section 3858, Burns' Revised Statutes, 1926, it is provided thaat whenever the capital stock of a bank is impaired, the board of directors shall proceed to levy an assessment on the stock. In the case of *Duke v. Force*,[14] the Supreme Court of Washington holds a similar statute invalid for the reason that the directors have no authority to levy an assessment, but that it must be made by the stockholders themselves.[15]

It has been held that a constitutional provision for double liability very similar to that of Indiana is a self-executing provision and that it may be enforced without special supplementary statutory enactments, and it has been held that such enforcement might be carried out by a receiver,[16] this last holding as to right of receiver would seem to be contrary to the Indiana rule, unless Sec. 4952, Burns' Rev. Statutes 1926, changes said rule.

In view of the authorities considered, the following conclusions might be stated:

1. The constitutional provision for double liability is self-executing and should be brought by creditor's bill, unless Sec. 4952 would control in which case a receiver could collect.

2. An assessment levied and collected to meet an impair-

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[13] 119 U. S. 634, 30 L. ed. 260, 7 Sup. Ct. Rep. 39.

[14] 208 Pac. 67.

[15] See following notes: 23 A. L. R. 1367; 45 A. L. R. 1215.

[16] *Farmers Loan & Trust Co. v. Funk* (Neb.), 68 N. W. 520; *Wilson v. Book* (Wash.), 43 Pac. 939.

ment of stock does not exclude an assessment under the constitution for payment of debts, and the amount paid under an assessment to meet impairment of capital cannot be set off against the constitutional liability. Our statutes seem to hold that the stockholders' liability to meet an impairment shall not exceed 100 per cent., but this might be construed to mean 100 per cent on one assessment, and on this interpretation would justify other assessments where the bank is a going concern, although the total amount assessed might exceed the 100 per cent.

Quaere. Do not the provisions of Sec. 3858, Burns' Rev. Statutes 1926, merely refer to the procedure for the collection of an assessment for impaired capital stock resulting in the sale of the stock, and not to an action resulting in a personal judgment against the stockholders, collectible out of the sale, if any, and to be used for payment of debts?

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