April 16, 1935.

Hon. James F. Byrnes,
Room 360, Senate Office Building,
Washington, D. C.

Dear Senator Byrnes:

In accordance with our conversation this afternoon, I am inclosing herewith separate memoranda on a number of legal questions which may be raised in connection with the confirmation of Hon. Marriner S. Eccles as a member of the Federal Reserve Board.

There is one memorandum discussing briefly the five most prominent cases regarding the liability of shareholders in two different forms of group banking organizations. In addition, there are separate memoranda containing more detailed discussions of each of these cases and also memoranda on separate pages regarding other cases which may be cited erroneously for the proposition that a stockholder in a holding company which owns bank stock is liable for a stockholders assessment on such stock.

Your especial attention is invited to the quotations from the colloquy on the floor of the Senate on January 9, 1933 between Senator Glass and Senator Wheeler regarding group banking, wherein Senator Glass stated that in group banking there is no double liability of stockholders and also praised very highly the Detroit Bankers Company, which failed less than two months later and precipitated the nationwide bank holiday.

I expect to be tied up all day Wednesday, April 17th, with the House Committee on Banking and Currency which is considering Title II of the pending Banking Bill; but, if you need anything further along this line, I can prepare it for you Wednesday night. If you need anything from us during the day, you can reach me in Mr. Steagall's office, or you can obtain it through Mr. George B. Vest, Assistant Counsel to the Federal Reserve Board.

Cordially yours,

Walter Wyatt,
General Counsel

Inclosures

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CASES RE LIABILITY OF SHAREHOLDERS OF CORPORATIONS OWNING BANK STOCK

There apparently have been only two cases of record in which the courts have held that a stockholder in a corporation which owns stock in a bank is liable for an assessment on such bank stock:

(1) Barbour v. Thomas, 7 F. Supp. 271 (now pending an appeal), wherein the court held the stockholders of the Detroit Bankers Company liable for an assessment levied against the stockholders of the First National Bank of Detroit; and

(2) Corker v. Soper, 53 Fed. (2d) 190, wherein the Circuit Court of Appeals for the Fifth Circuit held that, where a bank president organized a "dummy" corporation to hold shares of bank stock as his mere instrument or agency, he remains liable for assessments on such bank stock.

Neither case was based on the theory that a stockholder in a holding company is a stockholder in a bank owned by such holding company.

The first case was based upon specific provisions in the articles of association and stock certificates of the holding company whereby the shareholders of the holding company expressly agreed to assume liability for any assessments on bank stocks for which the holding company should be liable.

The other case was one in which, for the specific purpose of escaping stockholders' liability, a bank president created a "dummy" corporation with a nominal capital of $10, which never held any shareholders' meetings, issued any shares, kept any books, or did any business,

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but which merely acted as his agency, and the court held that under the facts of the case the title to the stock which the president attempted to transfer to such corporation never vested in the corporation but remained in the president. In other words, he was not held liable as a stockholder in the holding company but as the real stockholder in the bank, in accordance with a well settled rule that a fraudulent transfer of bank stocks for the purpose of escaping stockholders' liability is void and of no effect.

Two cases growing out of the failure of the National Bank of Kentucky (Keyes v. American Life and Accident Insurance Company, 1 F. Supp. 512 and Laurent v. Anderson, 70 Fed. (2d) 819) and one case growing out of the failure of the Federal National Bank of Boston (O'Keefe v. Pearson, 73 Fed. (2d) 673) involved arrangements whereby bank stock was placed in the hands of trustees who issued participation certificates to the beneficial owners; but in each case the trust instrument provided specifically that the holders of the trust certificates should assume all liability for assessments on such bank stock.

All of these cases are clearly distinguishable from the case of the Eccles Investment Company, which was not organized for the purpose of holding bank stock, but was organized over twenty years ago for the bona fide purpose of conserving the assets of the estate of Governor Eccles' father for the benefit of his widow and his nine children, seven of whom were minors. The assets of the Eccles Investment Company are not princi-

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pally bank stocks, but include a large variety of investments, including real estate bonds, notes and stocks of corporations engaged in widely diversified types of business. Moreover, Governor Eccles is not the sole or even a principal stockholder of the corporation, but has only a small minority interest therein, which amounts to less than 9 per cent of the total stock.

The Eccles Investment Company is in no sense a "dummy" corporation nor was it organized for the purpose of evading the provisions of the Federal Reserve Act nor the National Bank Act. There are no grounds whatsoever for disregarding its separate entity or for considering the transfer of stock to it as a fraudulent or fictitious transfer. On the contrary, the good faith of the transaction is evidenced by the fact that Governor Eccles sold all of his stock in the First Security Corporation to the Eccles Investment Company at a financial sacrifice of $90,870.25 and reported this capital loss in his income tax return for the year 1934 when he had a net capital gain of only $1,071.15, thereby waiving any right to deduct such capital loss from any capital gain which he might have in future years.

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LIABILITY OF SHAREHOLDERS OF DETROIT BANKERS COMPANY
FOR STOCK ASSESSMENT AGAINST STOCKHOLDERS OF
FIRST NATIONAL BANK OF DETROIT.

The decision of the United States District Court in the case of Barbour v. Thomas, 7 F. Supp. 271, (which is now pending on appeal) holding the stockholders of the Detroit Bankers Company liable for a stock assessment levied against the stockholders of the First National Bank of Detroit was not based upon the theory that the stockholders of the holding company were stockholders of the bank, but was based upon a specific provision in the articles of association of the holding company and a specific contract accepted by the stockholders of the holding company when they acquired stock in the holding company whereby the stockholders of the holding company specifically agreed to assume any stockholders' liability for which the holding company might be liable.

This is shown clearly by the following quotation from the opinion of Judge Hayes on page 273:

> "The Detroit Bankers' Company, hereafter referred to as the holding company, is a corporation for pecuniary profit, chartered under the general laws of the state of Michigan. It was not chartered as a banking institution. It was the registered owner of all of the capital stock of the First National Bank - Detroit, hereafter called the bank, except the qualifying shares of directors, when the bank was placed in the custody of a conservator, and later when a receiver was appointed. The

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The Comptroller has decided the necessity for, and levied, a stock assessment of 100 per cent. on all the outstanding stock. The question involved is this: Can the receiver of the bank enforce the assessment against the shareholders of Detroit Bankers' Company, or is he confined to the single remedy of proceeding against the corporation?

"The case presents a factual situation quite different from any case hitherto reported.

"The holding company came into existence through the combined efforts of the officers and directors of the First National Bank of Detroit and four state banks, all of Detroit. An appraisal of the value of the stock in each of the five banks was made, and an agreement reached on the basis for the exchange of the holding company stock for the stock in each of the five banks. The capital stock of the five banks amounted to several million dollars. The holding company was to issue 120 shares of no par value at $10 per chare, and $50,000,000 of par value stock. The no par stock was subscribed for by the twelve executive officers of the five banks, apportioned among the five banks, and these were to have exclusive voting power for five years. No one could be a director unless he owned 10 shares of trustee stock, and no one could vote except a trustee stockholder. Thus the destiny of these five banks was committed for five years to these twelve trustees, with an apparent investment of $1200. The investment was apparent and not real, for the banks put up the money to pay for the stock and charged it to expense.

"The Banking Commissioner, the Attorney General, the Secretary of State, and the Securities Commission of Michigan, before chartering the holding company or permitting it to sell or exchange its stock and do business in the state of Michigan, required the insertion of this clause in the articles of association.

"'Article IX. The holders of stock of this corporation shall be individually and severally liable (in proportion to the number of shares of its stock held by them respectively) for any statutory liability imposed upon this corporation by reason of its ownership of shares of the capital stock of any bank or trust company, and the stockholders of this corporation, by the acceptance of their certificates of stock of this corporation, severally agree that such liability may be enforced in the same manner as statutory liability may

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now or hereafter be enforceable against stockholders of banks or trust companies under the laws of the United States or the State of Michigan.'

"They further required that the clause be printed on each certificate of stock issued by the holding company."

The actual grounds for Judge Hayes' decision are stated in the following paragraph on page 278:

"The acceptance of this stock certificate was an assent by the shareholder to the terms of the contract assuming payment of the assessment. 2 Williston, Contracts, § 628, p. 1211. It is conclusive proof that the holder has contracted to be bound by the terms. Blue Mountain Forest Ass'n v. Borrows, 71 N. H. 69, 51 A. 670; Jacobs v. Miller, 50 Mich. 119, 15 N. W. 42; Hassel v. Pohle, 214 App. Div. 654, 212 N.Y.S. 561; Commissioner of Banks v. Prudential Trust, 242 Mass. 78, 136 N. E. 410; Grand Rapids & Indiana Ry. Co. v. Osborn, 193 U. S. 17, 24 S. Ct. 310, 48 L. Ed. 598."

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The case of Corker v. Soper, 53 Fed. (2d) 190, wherein the Circuit Court of Appeals for the Fifth Circuit held that where a bank president organized a corporation to hold shares of bank stock as his mere instrument or agency he also will be liable for assessments on the bank stock, is a case in which the corporation was a mere sham with only a nominal capital of $10 and never transacted any business on its own account whatever. The facts regarding the organization of the company are stated as follows in the opinion:

> "The facts as to the Laurens Company and its organization are: On February 3d the charter of the Laurens Investment Company, Inc., on a petition filed December 27, 1927, was issued, with an authorized capital stock of $10, Corker and his two sons incorporators. On the next day the capital stock was subscribed for, by-laws were adopted, the subscription of F. G. Corker as agent for the Laurens Company to 150 shares of the Dublin Bank stock was ratified, and it was resolved that the Laurens Company purchase Mrs. Corker's stock in the bank, and that of appellant, except 21 shares which he retained to qualify him as a director in the bank; and that it give to appellant and his wife notes dated back to January 5, 1928, bearing interest at 8 per cent., representing the par value of 156½ and 28 shares respectively, making up the total of 184½ shares which stood in the name of the Laurens Company. The January dividends already paid were credited on these notes. No other corporate action was ever taken by the Laurens Company, its stockholders, or its officers. It issued no stock certificates, kept no books,had no seal. The only money it ever possessed was the $20 paid by appellant for organization expenses. It claimed no assets, except the stock in its name; it had no credit; the money with which the stock was purchased was acquired entirely upon the credit of appellant. No record except the credit on the back of the notes was ever made of the receipt by it of dividends. It was organized for the sole purpose of owning the bank

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stock, pursuant to the idea of appellant that its organization and the placing of the stock in its name would prevent his being liable for stock assessments.

"There is no evidence in the record of any activity of Laurens Investment Company except in name. Every transaction had by or with reference to it was managed, controlled, and directed by appellant, and it functioned entirely as an agency or instrumentality of his. * * * "

(page 191)

There were allegations in the bill that the stock was placed in the name of Laurens Investment Company fraudulently for the purpose of avoiding liability at a time when the bank was insolvent or in danger of becoming so and this would seem to be the true ground for holding the bank president liable. Unfortunately, however, these allegations were abandoned at the trial and the Court was forced to find some other theory upon which to base liability. It did so by the following rather peculiar line of reasoning:

"Appellant's troubles do not arise from the fact that the corporate entity of the Laurens Company has been disregarded. The judgment of the court below fully recognized and gave effect to that entity. It found that, though it did in fact exist, it existed as a mere creature organized and maintained for the purpose of holding, not really, but as agent for appellant, the stock which he caused to be put in its name, that appellant at all times remained the real owner of the shares, and that the law will look through the subterfuge of pretended ownership to fasten liability upon the shareholder to whom, in fact, the shares belong.

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"The view which the court below took, and which we take, does not require, in fact, it prevents, the conclusion that the corporation in this case was a fiction, having no corporate existence. In this view, the judgment, thoroughly consistent with itself, stands upon the sound foundation on which alone a just disposition of the case may rest. It correctly gives effect to the general intent of appellant to create a corporation for the purpose of placing in its name his and his wife's stock in the bank, because what was done made that intent effectual. It with equal correctness denies effect to the particular intent which induced him to act as he did, to avoid liability on the stock, because the things done by appellant were not in accord, but wholly inconsistent, with that intent. For while the things done did place the certificates of stock in the name of the Laurens Company, they did not divest appellant of his beneficial ownership of them, but left him the real owner, and therefore liable to assessment."

(Page 192)

In other words, although the Court recognized the separate corporate entity of the holding company, it held that in fact the holding company was not a real stockholder of the bank, but was the mere agent or instrumentality of the bank president. This is quite different from holding that a shareholder in a bona fide holding company is a shareholder in a bank whose stock is owned by such holding company.

Moreover, the case is easily distinguishable from that of the Eccles Investment Company, which is a bona fide corporation organized over twenty years ago, and which owns a large variety of investments, including real estate, bonds, notes, and stocks of corporations engaged in widely diversified types of business.

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TWO NATIONAL BANK OF KENTUCKY CASES.

The case of Keyes v. American Life & Accident Ins. Co., 1 F. Supp. 512, decided August 17, 1932 by the United States District Court for the Western District of Kentucky, did not hold that a stockholder in a holding company is a stockholder in a bank owned by such holding company. In fact, there was no holding company involved at all but merely an arrangement whereby the stock of the bank was held by trustees who issued participation certificates to various investors.

The facts in the case are summarized very briefly as follows in a head note published on page 512:

> "After the merger of the banks was accomplished by the exchange of stock, stockholders placed their stock in legal ownership of trustees to hold for their benefit under terms of trust agreement whereby trustees were empowered to vote the stock in each institution subject to control of certificate holders, and were to collect the dividends and distribute them among the holders. Some of the certificates were held by former stockholders who transferred stock in exchange for certificates, but most of the certificates were held by another bank acquiring them by purchase. The trust agreement expressly provided that owners of the certificates should be subject to the same liabilities as if they had been owners of proportionate part of shares held by the trustees, and should indemnify trustees for any loss or liability."

The court held that the beneficial owner of the stock was liable for the assessment notwithstanding the fact that the stock was registered in the hands of the trustee. In so holding the court stated:

> "It is well settled, as much as it is possible, that the actual and real owner of stock of a national bank is liable to assessment, whether his name appears on the books as owner or not. Where such stock is held by one in trust for another, such other is the actual and real owner. There is no room to question this. The beneficial owner is the actual and real owner. * * * It is unthinkable that a legal

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owner of such stock can relieve himself of liability by the device of transferring it to another for his benefit. In such case he is as much the actual and real owner as he was before the transfer."

This case is easily distinguishable from the case of a corporation owning bank stock because it is well settled that property of a corporation belongs to it and not to its stockholders. Steinfeld v. Copper State Company, 290 Pac. 155.

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Another case arising out of the situation discussed in Keyes v. American Life & Accident Ins. Co. above was that of Laurent v. Anderson, 70 Fed. (2nd) 819. In this case also the holder of the Trustees Participation Certificates agreed to be liable for a stock assessment on the stock of the National bank.

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The very recent case of O'Keefe v. Pearson, 73 F(2d) 673, which was decided on December 1, 1934 by the Circuit Court of Appeals for the First Circuit, did not involve a holding company but involved a trustee arrangement similar to that involved in the National Bank of Kentucky cases (Keyes v. American Life & Accident Ins. Co., 1 F. Supp. 512, and Laurent v. Anderson, 70 F. (2d) 819).

The stock of the Federal Trust Company, which was later converted into the Federal National Bank of Boston, was delivered to a trustee in return for trust certificates. The trustee was to hold the shares for the holders of such trust certificates, to pay over all earnings to them, and to deliver the shares to them upon termination of the trust. The holders of the trust certificates retained the right to vote the shares. Moreover, the trust agreement contained the following specific provision whereby the holders of the trust certificates undertook to pay any assessment levied upon the shareholders of the bank:

> "In the event of any assessment being made or ordered upon the stockholders of the Federal Trust Company each registered holder of a trust certificate hereby agrees for himself, his heirs, executors, administrators and assigns to forthwith pay such assessment as may be made upon or against the stock of the Federal Trust Company held by the Depositary under this agreement and represented by the trust certificate held by him at the time such assessment is made or ordered, and while such assessment is unpaid, no trust certificate shall be transferred or new certificate issued therefor."

In accordance with the well established rule that assessments levied on stockholders of National banks are collectible from the real owners of the shares rather than the nominal or fictitious owners, the

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Court held that the holders of the trust certificates were liable for the assessment.

This case is easily distinguishable from the case of a corporation owning bank stock, because it is well settled that property of the corporation belongs to it and not to its stockholders. Steinfeld v. Copper State Mining Company, 290 Pac. 155.

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