X-7926

ARTICLE APPEARING IN THE NEW YORK HERALD TRIBUNE OF JUNE 12, 1934, IN REGARD TO THE DECISION HANDED DOWN ON JUNE 11 BY JUSTICE LOUIS A. VALENTE IN THE SUPREME COURT OF NEW YORK IN AN ACTION BROUGHT BY MR. JOSEPH A. BRODERICK, STATE SUPERINTENDENT OF BANKS, AGAINST TWELVE OFFICERS AND DIRECTORS OF THE BANK OF THE UNITED STATES.

"12 BANK OF U. S. OFFICIALS LIABLE FOR 28 MILLION

Judgments Hold Directors 'Supinely Acquiescent' in Making Illegal Loans

Twelve officers and directors of the defunct Bank of United States were held responsible for losses of $28,473,653.75 by a decision handed down yesterday by Justice Louis A. Valente, in Supreme Court. Four judgments totaling this amount were directed against the bank officials in a suit for $60,000,000 brought by Joseph A. Broderick, State Superintendent of Banks.

In an opinion which is expected to have an important effect on the liquidation of banks throughout the country, Justice Valente held that the directors are 'charged with the trust responsibility to see that the depositors' funds are safely and providently invested' and that they had 'supinely acquiesced' in the making of 'speculative, unsecured and improvident loans.'

As two of the defendants in the suit, Bernard K. Marcus and Saul Singer, president and executive vice-president of the bank, respectively, are now serving sentences in Sing Sing for misapplying funds of an affiliate of the bank, and others are in bankruptcy, the practical result of the decision in the collection of funds to aid depositors of the bank remains problematical.

The bank was closed on December 11, 1930. The suit in which the present decision was rendered was brought to recover losses sustained by the bank as a result of alleged violation by the defendants of their duties as directors. It went on trial in January of this year and continued for six weeks. Justice Valente held in his decision that the reason for a higher standard of diligence required of banking directors as compared with that of other corporations is obvious, and that it is not for the bank director to wait for knowledge about the bank's investments 'until the facts are thrust in his face.'

Four Judgments Listed

Judgments against the officials were as follows:

Judgment for $12,760,773.75 -- Against Bernard K. Marcus, Saul Singer, Joseph C. Brownstone, John F. Gilchrist, Jacob L. Hoffman, Reuben Sadowsky, George C. Van Tyle jr., Israel H. Rosenthal and Morris White.

Judgment for $7,640,500.00 -- Against William Fischman.

Judgment for $7,672,380.00 -- Against Harry H. Revman.

Judgment for $400,000.00 -- Against Morris Weinberg.

Carl J. Austrian, chief counsel in the liquidation of the bank, devoted the greater part of a year to the preparation of the case, which involves the rarely litigated question of the responsibility of bank directors to depositors. Mr. Austrian said yesterday that the judgments should have an important influence on the matter of bank liquidations elsewhere. During the trial some of the defendant directors admitted on the witness stand that they had known little of the actual operations of the bank and had relied on the experience and statements of Marcus and Singer.

In the original suit forty officials were named. Twenty-five of them effected settlements which met with the approval of the court and brought about $2,000,000 to the State Department of Banks to be applied to the liquidation of the institution. Thirteen made settlements before the case went to trial and twelve while the trial was in progress, among the latter being Isidor J. Kresel, counsel to the bank, who was convicted of misapplication of the assets of the bank and is now free on bail pending appeal.

The suit against three defendants, Henry Loeb, Stephen Stephens and Joseph Brown, was discontinued because they had left the jurisdiction of the court and could not be served with the summons and complaint.

Those who made settlement before the trial were Robert Adamson, George Le Boutillier, Joseph Durst, Isaac Gilman, Frank Hedley, Eugene B. Kline, Edward B. Lewis, Arthur W. Little, the late Herman A. Metz, Charles H. Silver, David Tishman, Alexander C. Walker and Max Weinstein. Those who arranged settlements while the trial was in progress, in addition to Mr. Kresel, were Henry W. Pollock, Max H. Friedman, Simon H. Kugel, Irwin S. Chanin, Albert Rosenblatt, George S. Carr, A. Milton Napier, estate of Frederick G. Hobbs, Joshua L. Coken, estate of Julius Blauner and C. Stanley Mitchell, chairman of the board. The individual payments ranged from $5,000 to $150,000.

Justice Valente found that the principal losses of the bank resulted from unsecured loans to the Bankus Corporation, one of the chief affiliates of the bank. Transactions of the bank with this affiliate and two of its subsidiaries, according to the court's decision, resulted in a loss of almost $12,000,000 to the bank, the unsecured loans in these cases amounting to more than 25 per cent of the bank's capital and surplus which was never higher than $47,000,000.

Justice Valente's Decision

Justice Valente's decision follows, in part:

'Counsel for the plaintiff with indefatigable industry has fully developed the details regarding the various alleged improvident loans, and has presented them with commendable clearness and in systematic arrangement. The amount of the loans and the fact of the losses is beyond question. The only thing to be considered is whether these losses are to be chargeable against the defendants. The action against the directors involves their accountability from a double aspect; first, that the loans were improvident in that they were made upon no security to corporations without substantial assets, and, secondly, and more important, that in making the loans which have resulted in the losses referred to the directors violated the banking laws, and the consequences of such violation are the losses of millions of dollars to the bank and its creditors.

'It is not necessary to assume that those responsible for making the improvident loans acted from corrupt motives or with a purpose of making individual gain. The general inference to be drawn from the setup of the Bankus Corporation is rather the opposite. The directors by means of stock speculation through the instrumentality of the Bankus Corporation, using funds furnished by the Bank of United States, expected to make large profit for the stockholders of Bankus and for those of the bank. The gross impropriety of such a practice of jeopardizing, by highly speculative transactions, the funds entrusted to the bank by depositors, is selfevident.

'The irony of it is that the very stockholders whom it was intended to benefit have lost their entire investment and have been subjected to liability as well. Upon whom shall responsibility for the losses resulting from such breach of trust be visited? Obviously, the officers and the members of the executive committee who were the prime agents in the dissipation of the funds in the manner described are responsible in the first instance. To what extent is this responsibility to be shared by the other directors?

Cites Director's Oath

'The statutory oath which a director of a financial institution is required to take binds him diligently and honestly to administer the affairs of the bank. The commands and the prohibitions contained in Section 108 of the banking law are mandates to the directors.

'As is said in People v. Knapp (206 N. Y. 373, 381):

'"A command addressed to a corporation would be idle and vain unless the legislature in directing the corporate body, acting wholly by its directors, to do a thing required or not to do a thing prohibited, meant that the directors should not make or cause the corporation to do what was forbidden, or omit to do what was directed."

'Consequently, the violations of Section 108 in which directors knowingly participate, makes them severely accountable for damages which such participation occasions. But, further, a failure by a director to inquire what those actively administering its affairs are doing may in itself be a violation of the director's duty and of his statutory oath. Thus, in Martin v. Webb (110 U. S. 7, 15) it was said:

'"Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than from time to time to elect officers of the bank and to make declarations of dividends."

'And in Briggs v. Spaulding (141 U. S. 132, 165) it is said that their duties are more than officiating as figureheads. While they are entitled under the law to commit the banking business to the duly authorized officers, it does not absolve them from the duty of reasonable supervision nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is a result of gross inattention.

Calls U. S. Rulings Applicable

'The decisions of the United States Supreme Court, based upon the national banking act and the duty of directors of national banks, is fully applicable in the state courts. In Kavanaugh v. Commonwealth Trust Co. (223 N. Y. 103) the duty of directors is thus stated:

> '"They should know of and give direction to the general affairs of the institution and its business policy, and have a general knowledge of the manner in which the business is conducted, the character of the investments and the employment of the resources. No custom or practice can make a directorship a mere position of honor void of responsibility, or cause a name to become a substitute for care and attention. The personnel of a directorate may give confidence and attract custom; it must also afford protection."

'The reason for the higher standard of diligence required of banking directors as compared with that of other corporations is obvious. While legalistically the relation between the bank and its depositors is that of debtor and creditor, practically the directors are charged with the trust responsibility to see that depositors' funds are safely and providently invested. The bulk of the funds of a bank usually are spread out in the form of loans to the business community to help the wheels of industry revolve, and the main responsibility of the director is for the safe and legal application of the bank funds in the form of loans and investments. It is not for him to wait until the facts are thrust in his face. He must at all times take the initiative in examining the loan portfolios. It is no defense, therefore, as one or two of the directors have attempted to assert, that certain loans were not called to their attention or that they were absent at a certain meeting when a particular loan was approved. A sufficient period elapsed since the making of the loan to enable them to inquire into its propriety, and since they took no steps in protest they must be deemed to have ratified it. In the Kavanaugh case the defendant director even appeared never to have gone near the bank, to have known nothing of its affairs and to have given no attention to its business, yet the court held that if the proof showed that his neglect contributed to the losses he was liable.

'The disregard of all sound banking principles in the making of the speculative, unsecured and improvident loans resulted in huge losses for which not only those who actively directed the making of such loans are responsible, but also those who as directors supinely acquiesced in them or failed to inquire into the character of the loans. Every vestige of possible defense, based upon an honest mistake of judgment is destroyed by the fact that the loans which resulted in the losses were made in violation of the banking laws. These infractions of the law may also be said to be the direct and proximate cause of the losses. Surely if the directors illegally made loans in excess of 10 per cent of the capital and surplus the loss of that excess must be chargeable to the directors, for if they had not loaned the money in violation of the law there would have been no opportunity for the loss. Again, losses on loans which were made without security for the purpose of enabling the borrower to pay for or hold shares of the stock of the bank, must also be chargeable to the directors, for if they had not made the illegal loan the loss would not have occurred.

'I have indicated in the findings various amounts for which the directors are severally liable, after giving effect to a credit resulting from settlements with some of the directors. Some remarks on the settlements are appropriate here, because one of the defending directors has argued that his liability should be no greater than the largest amount secured from any director by way of settlement. I can see no basis for such a bizarre proposition. Settlements were made with directors upon the basis of their ability to pay, and only after a searching examination into their affairs. It seemed wiser in the liquidation to secure some practical benefits for the creditors than to give them the doubtful benefit of fantastic judgments against directors, which might be wiped out by proceedings under the Bankruptcy Law. The amount secured in settlements either by present payment or by assured promise of payment is $1,600,000. The entry of judgment against these directors who have not settled does not necessarily foreclose them from any efforts to obtain an adjustment, although it may make their road harder. I have also considered the separate defenses of defendant Sadowsky, especially the defense of the three years' statute of limitations, and find them without merit.'"