WALLACE v. HOOD.

(Circuit Court, D. Kansas, First Division. August 18, 1898.)

1. NATIONAL BANK—EFFECT OF PURCHASE AND RESALE OF ITS OWN STOCK.
   The statutory inhibition against the purchase by a national bank of its own stock does not render stock so purchased void; and where, in such case, the stock is held for the bank by a nominal owner, a subsequent purchaser for value received by the bank acquires a good title, which cannot be questioned by the bank or its creditors.
2. SAME—LIABILITY OF STOCKHOLDERS—RESCISSION OF PURCHASE OF STOCK AFTER INSOLVENCY.
   Though a person may have been induced by fraudulent representations to purchase stock of a national bank, the contract is voidable only at his option; and, where he has not discovered the fraud nor made his election at the time the bank passes into the hands of a receiver, he is apparently a stockholder, and can only escape liability as such by affirmatively alleging and proving the fraud, acts of diligence which negative any charge of negligence, and that no debt was created nor credit given the bank after he became such stockholder.
3. SAME—ACTION TO ENFORCE ASSESSMENT—DEFENSES.
   A stockholder, by purchase in a national bank which has conducted business as such for six years, cannot defend against an assessment, on its insolvency, on the ground that the original capital stock was never paid in.
4. SAME—RESCISSION OF PURCHASE OF STOCK—TENDER.
   One induced to purchase stock of a national bank by fraudulent representations of the bank, which was in fact the owner of the stock and received the price, cannot make an effectual tender of rescission which will support an action at law to recover the purchase price after the appointment of a receiver for the bank, as neither the bank nor the receiver then has authority to rescind and make restitution of the purchase money.
5. SAME—COUNTERCLAIM AGAINST RECEIVER.
   In an action by the receiver of a national bank to enforce an assessment against a stockholder, the latter cannot maintain a cross petition in the nature of a counterclaim to recover the purchase price of his stock on the ground of the alleged fraud of the bank inducing its purchase by defendant. The proper proceeding in such case is by an independent bill in equity against both the receiver and the bank for a rescission, making tender of the stock.

This is an action by plaintiff, T. B. Wallace, receiver of the Missouri National Bank, at Kansas City, Mo., to recover of the defendant the sum of $10,000,—the amount of an assessment made upon him, as a shareholder in said bank, by the comptroller of the currency.

The defendant became the purchaser of said stock in April, 1896. On the 3d day of December, 1896, the bank was taken charge of by the comptroller of the currency, and plaintiff was appointed receiver thereof. On the 30th day of July, 1897, the comptroller of the currency made an assessment equal to the face value of the stock, as prescribed by sections 5151 and 5234 of the Revised Statutes, for the benefit of creditors of said bank. Due notice of this assessment was given to the defendant, and payment thereof was requested to be made on or before the 30th day of August, 1897. The defendant failing to comply therewith, this suit was instituted October 30, 1897. The defendant appeared, and has filed several amended and supplemental answers. His final substituted answer pleads in defense that he was deceived into the purchase of said stock by the false and fraudulent representations made to him by the president of the bank as to its financial condition and business. These misrepresentations are set out in great detail

in the answer. In explanation of the delay in interposing any objection to the defendant's relation as stockholder of the bank, and to avoid the implication of laches on his part, the answer pleads, in substance, that, notwithstanding diligence and every reasonable effort on the part of the defendant to discover the exact condition of the affairs of the bank, he failed to do so, up to the time of the appointment of the receiver, because of the artful concealments of the facts from him by the officers of the bank, and the artful manner in which the books of the bank were kept, and that after appointment the receiver persistently refused to allow him reasonable access to the books of the bank for examination and discovery of its true condition, and that he was postponed in his efforts by repeated assurances of the receiver that the assets of the bank were sufficiently ample to satisfy all of its debts and liabilities without recourse to an assessment upon the stockholders; that after the assessment made by the comptroller of the currency he obtained an order and permission from said comptroller about the 1st of September, 1897, to make such examination of the books of the bank as he desired, and that he did not fully discover the true facts of the case until the latter part of October, 1897, and on the 27th day thereof he made tender of the certificate of stock to the receiver, and demanded of him the return of the purchase money, which was declined; that no officer of the said bank to whom such tender could be made could be found, for the reason that said officers had left the state. The answer further pleaded that the stock in question had once been sold, and certificates issued therefor to the purchasers, and that, the financial condition of the bank becoming embarrassed, in order to prevent the holders of said certificates from putting them on the market and thereby discrediting the bank, the managing officers thereof had the employés of the bank purchase said stock from said holders, and take transfers thereof in the name of such employés, who were wholly insolvent,—the bank furnishing the money for such purchase,—and that said employés so held the same in fact and law for the use and benefit of the bank, as the real owner; that, when the defendant was induced to take said stock, it was accomplished by said employés surrendering said certificates for cancellation, and certificates were then issued by the bank to the defendant, the defendant being ignorant of said arrangement and scheme. It is finally alleged as matter of defense that no part of the original or reduced capital stock of the bank was ever actually paid for, as required by the banking laws of the United States, and that said capital stock had in many instances been issued to irresponsible parties, and worthless notes taken therefor. The defendant also presents with his answer what is called a "cross petition," in the nature of a counterclaim, for the recovery back of the amount of the purchase money paid the bank for said stock. The plaintiff has filed motions to strike out the answer and cross petition, and also demurrers thereto. After oral argument by the respective counsel, and amendments to the answer, the motions and demurrers have been submitted to the court on briefs.

William H. Wallace, Trimble & Braley, and W. C. Cochran, for plaintiff.

Eugene Hagan, C. N. Sterry, and I. E. Lambert, for defendant.

Before WILLIAMS and PHILIPS, District Judges.

PHILIPS, District Judge (after stating the facts). Deferring for later consideration the application of the motion and demurrer interposed to the last amended answer herein, a general discussion of the relation of the defendant to the creditors of the bank at the time of its declared insolvency and the appointment of a receiver will determine whether or not the matters pleaded in the answer constitute a good defense in law to the action brought by the receiver to recover the assessment made upon the defendant as a stockholder in the insolvent bank.

In respect of what may be termed the first defense, it is settled law that, notwithstanding the party may have been inveigled by fraudulent representations of the vendor into the purchase of shares of stock in an incorporated company, the contractual relation thus apparently established between him and the corporation and the other stockholders is not void, but only voidable at the election of the party defrauded. He may, notwithstanding the deception practiced upon him, prefer to stand by his bad bargain, and make the most of it. Therefore, the defendant not having discovered the alleged fraud nor having made his election to repudiate the contract at the date of the appointment of the receiver, both by the terms of his certificate and the stock book of the bank he was an apparent stockholder.

And, in respect of what is termed his second additional matter of defense, it is equally clear that he became and was at the time of the appointment of the receiver the legal and equitable owner of the 100 shares of stock purchased by him, both as against the bank and its creditors. When first issued, the stock in question was the authorized stock of the bank. It was not an overissue or an unauthorized issue, and therefore its issue was not ultra vires. In this respect the case is radically different from that class of cases cited by defendant's counsel where the bank had issued stock in excess of its authorized capital, or in the instance of stock purporting to be part of the increased capital, which had not been authorized by the approval of the comptroller of the currency. In such instances the act of the bank was clearly ultra vires. The stock so issued was void ab initio, as it never had any legal existence; and therefore, in contemplation of law, the purchaser of such stock acquired no property rights, nor privileges of a stockholder, and consequently did not become subject to the responsibilities and liabilities of a stockholder. Not so in respect of the purchaser of authorized valid stock. It must be conceded by the defendant that the first purchasers of the stock, when sold by the bank, became bona fide holders for value; and if, when they transferred their stock to the alleged dummy man of the bank, they did so in good faith, in ignorance of the alleged scheme of the bank, they were discharged from their liability as stockholders. And it is further to be conceded, under the allegations of the answer, that the transfer of stock to the employés of the bank as mere instruments of the bank—the bank in fact paying the consideration money for the transfer—rendered the bank the real purchaser. Under the statute the bank was not allowed to thus buy its stock, but this did not invalidate and make void the stock itself. The object and the policy of the statute in prohibiting a bank from purchasing outright its stock is to prevent the reduction of its outstanding stock, and the withdrawal pro tanto of its capital. Bank v. Lanier, 11 Wall. 374, 375. While the bank or receiver may go upon the vendor to recover back the purchase money in order to restore the capital, it must be the law that where a subsequent purchaser from the bank, like the defendant, acquires the stock through a simulated holder for the bank, in ignorance of the fact that the bank had employed its funds in placing the stock in the name of such simulated owner, the defendant paying therefor in good faith, his title to the stock is good against the bank and its creditors. The

purchase money paid by defendant went into the funds of the bank, whereby the equilibrium of the capital was restored; and no injury thereby was done to any stockholder, or to any creditor, or to the defendant. No one could complain, but the government, which might, if it deemed it politic, proceed as for a forfeiture of the charter of the bank. In Bank v. Stewart, 107 U. S. 676, 2 Sup. Ct. 778, Mr. Justice Field, in discussing section 5201, Rev. St. (National Banking Act), which prohibits a banking association from making a loan upon the security of shares of its own bank, said:

"It imposes no penalty, either upon the bank or the borrower, if a loan upon such security is made. If, therefore, the prohibition can be urged against the validity of the transaction by any one except the government, it can only be done before the contract is executed, while the security is still subsisting in the hands of the bank. It can then, if at all, be invoked to restrain or defeat the enforcement of the security. When the contract has been executed, security sold, and proceeds applied to the payment of a debt, the courts will not interfere in the matter. * * * Supposing it was unlawful for a bank to take those shares as security for a loan, it was not unlawful to authorize the bank to sell them when the contingency occurred. The shares being sold pursuant to the authority, the proceeds would be in the bank, as his property."

On principle, therefore, if it was unlawful for the bank to purchase, as alleged, the shares of stock in question, it certainly was not unlawful to sell them. Being sold, the proceeds went into the bank, restoring its capital, inuring to the benefit of its creditors. As said by Mr. Justice Swayne in Bank v. Matthews, 98 U. S. 626:

"The intent, not the letter, of the statute, constitutes the law. * * * Where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose. * * * So, an alien forbidden by the local law to acquire real estate may take and hold title until office found. We cannot believe it was meant that stockholders and depositors and other creditors should be punished, and the borrower rewarded, by giving success to the defense whenever the offensive fact shall occur. The impending danger of a judgment of ouster and dissolution was, we think, the check, and none other, contemplated by congress."

In legal effect, the attitude of the defendant is precisely like that of the purchaser of real estate from a corporation, the charter of which prohibits it from taking and holding real estate beyond certain specified quantities and for certain uses. The purchaser for value, in good faith, nevertheless acquires a good title as against the corporation, and its creditors cannot avoid payment of the purchase money. Railway Co. v. Proctor, 29 Vt. 93; Land v. Coffman, 50 Mo. 243-254. No authority has been cited, and, we take it, none can be found, sustaining the proposition that the defendant's purchase of stock under such circumstances was void. Certainly neither the bank nor the receiver has any ground of action against him for the cancellation of his certificate of stock. The bank obtained his money, which went to augment its assets for the benefit of both the stockholders and creditors. The defendant is not in the attitude of one who has sold stock outright to the bank, who thereby, as has been repeatedly held, becomes liable to an action for money had and received to the use of the bank, because in thus selling the stock to the bank he must take