1439.

STATE BANK—LOANING MONEY TO HOLDING CORPORATION OWNING ALL OR PART OF SUCH BANK'S STOCK AND ACCEPTING THE CORPORATE STOCK AS SECURITY—WHEN LEGAL.

SYLLABUS:

A state bank, the stock of which is owned in whole or in part by a corporation organized under the laws of this state, may legally loan money to such corporation and accept as security for such loan the stock of the holding corporation. Where, however, the stock of the bank constitutes all or substantially all of the assets of the holding corporation, the courts might properly disregard the corporate fiction and consider the loan as one secured by the shares of the bank within the inhibition of Section 710-114 *of the General Code.*

COLUMBUS, OHIO, January 23, 1930.

HON. O. C. GRAY, *Superintendent of Banks, Columbus, Ohio.*

DEAR SIR:—This will acknowledge receipt of your recent communication which reads as follows:

> "A corporation has been organized under the laws of this state for the purpose of purchasing and holding bank stock.
>
> I would appreciate your opinion as to whether or not a state bank, the stock of which is owned in whole or in part by such corporation, may legally loan money to it and accept as security therefor stock of such corporation."

There is no question raised in your communication as to the legal right to organize a corporation for the purpose of acquiring and holding bank stock, and, therefore, that right is not here considered.

The theory of separate entity of a corporation is not disturbed by the ownership of a large part or all of its stock by another corporation. The holding company owning a majority of the stock of another corporation is a separate entity just the same as if an individual stockholder owned a majority of the stock of a corporation. Such holding company, as I have hereinbefore indicated, has a separate corporate existence and is to be treated as a separate entity, unless such corporation exists as a mere sham or has been used as an instrument for concealing the truth. *Fletcher Cyc. Corporations,* Vol. X, page 4.

In the case of *Brundred et al.* vs. *Rice,* 49 O. S. 640, it is held in the third branch of the syllabus as follows:

> "Where the real purpose for which a corporation is formed is to use it as an instrumentality in the accomplishment of an illegal purpose, the fact of incorporation will not avail the promoters as a defense in a suit against them to recover money obtained from the plaintiff by such methods."

The Supreme Court of Ohio further held in the case of *First National Bank of Chicago, et al.* vs. *Trebein Company et al.,* 59 O. S. 316, that:

> "The good faith of the parties to such a transaction must be determined by its legal effect on the rights of others. If its legal effect works a fraud on their rights, the finding of a court that the parties acted in good faith is simply an erroneous conclusion of law from the facts."

In the case of *The Cincinnati Volksblatt Company* vs. *Hoffmeister,* 62 O. S. 200, Judge Spear in his opinion said:

> "We would add, however, that the rights of the plaintiff in this case are based upon a recognition of his standing as an integral part of the corporation. The idea that the corporation is an entity distinct from the corporators who compose it, has been aptly characterized as 'a nebulous fiction of thought'. Much learning has been indulged in and much space occupied by text-writers and others in an effort to differentiate the essential character of a corporation from that of its stockholders, and great ingenuity has been displayed in the argument, but it has been in the main a fruitless metaphysical discussion. For the purpose of description and in defining corporate rights and obligations, and characterizing corporate action, the fiction that the corporation is an artificial person or entity, apart from its members, may be convenient and possibly useful, but in the opinion of the writer the argument favoring the essential separate entity of the corporation fails, and it is believed that the effort has resulted in misleading conceptions and in much confusion of thought upon the subject."

Section 710-114, General Code of Ohio, reads in part as follows:

> "No bank shall loan money on the security or pledge of the shares of its capital stock; * * * "

The provisions of the above statute are plain and unambiguous and clearly a bank could not loan on the security or pledge of its capital stock. However, since the holding company is to be considered a separate entity, I can see nothing in the provisions of Section 710-114, supra, which would prohibit a bank from loaning to a corporation holding all or part of its capital stock and accept the capital stock of such holding company as security for the loan. In other words, I do not believe that the capital stock of the holding corporation can in any wise be held to be considered as capital stock of the bank.

A somewhat different situation might exist, however, if the corporation were organized for the purpose of holding all of the stock of some one particular bank. In the case of *State ex rel.* vs. *Standard Oil Co.,* 49 O. S. 147, at page 177, Minshall, Judge, said:

> "The general proposition that a corporation is to be regarded as a legal entity, existing separate and apart from the natural persons composing it, is not disputed; but that the statement is a mere fiction only in idea, is well understood, and not controverted by any one who pretends to accurate knowledge on the subject. It has been introduced for the convenience of the company in making contracts, in acquiring property for corporate purposes, in suing and being sued, and to preserve the limited liability of the stockholders, by distinguishing between the corporate debts and property of the company, and of the stockholders in their capacity as individuals. All fictions of law have been introduced for the purpose of convenience and to subserve the ends of justice. It is in this sense that the maxim *in fictione juris subsistit aequitas* is used, and the doctrine of fictions applied. But when they are urged to an intent and purpose not within the reason and policy of the fiction they have always been disregarded by the courts. Broom's Legal Maxims, 130. 'It is a certain rule,' says Lord Mansfield, C. J., 'that a fiction of law shall never be contradicted so as to defeat the end for which it was invented, but for every other purpose it may be contradicted.' "

In the case of *Parkside Cemetery Association* vs. *Cleveland B. & G. Lake Traction Co.*, 93 O. S. 161, Johnson, Judge, said at page 168:

> "That a corporation is a legal entity, apart from the natural persons who compose it, is a mere fiction, introduced for convenience in the transaction of its business and of those who do business with it; but like every other fiction of the law, when urged to an intent and purpose not within its reason and policy, it may be disregarded."

These authorities indicate that the courts under proper circumstances do not hesitate to look through the corporate fiction. Where the sole asset of a holding corporation consisted of the stock of its subsidiary,—a bank,—a loan by the bank to the holding corporation, might well be regarded as a loan by the bank upon its own stock. It is necessary, therefore, to exclude such a situation from the terms of the general conclusion which I reach.

This rule which I have suggested should perhaps apply also in cases where the assets of the holding company other than the stock of the bank are negligible, or of such a nature as to be construed as being held to avoid the rule.

Section 710-122, General Code, provides in part as follows:

> "A bank shall not lend, including overdrafts, to any one person, company, corporation, or firm, more than twenty per cent of its paid-in capital and surplus, unless such loan be secured by first mortgage upon improved farm property in a sum not to exceed sixty per cent of its value."

By virtue of the above section authority exists whereby a bank might loan to the holding company not more than twenty per cent of its paid-in capital and surplus, even though no security be given for such loan. The bank would have no authority to loan to the holding company any amount in excess of twenty per cent of the paid-in capital and surplus if the stock of the holding company were pledged as security. It will, therefore, be seen that the pledging of stock as security for the loan is but an incident to the loan, and but for the provisions of Section 710-114, supra, the pledging of stock as security for a loan is nowhere considered in the banking laws of this state. As hereinbefore indicated, I do not believe that this section applies in the case to which you refer in your communication.

Therefore, in specific answer to your inquiry, you are advised that I am of the opinion that a state bank, the stock of which is owned in whole or in part by a corporation organized under the laws of this state for the purpose of purchasing and holding bank stock, may legally loan money to such corporation and accept as security for such loan the stock of the holding corporation. Where, however, the stock of the bank constitutes all or substantially all of the assets of the holding corporation, the courts might properly disregard the corporate fiction and consider the loan as one secured by the shares of the bank within the inhibition of Section 710-114 of the General Code.

Respectfully,

GILBERT BETTMAN,

Attorney General.