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"ENTIRE CAPITAL STOCK" MEANS CAPITAL STOCK SUBSCRIBED FOR AND ISSUED—NOT AMOUNT AUTHORIZED IN ARTICLES OF INCORPORATION OR CHARTER—SECTION 9366 G. C. — LIFE INSURANCE, FOREIGN STATE — WHERE CAPITAL STOCK HAS BEEN PAID FOR IN WHOLE OR IN PART BY SUBSCRIBER'S PROMISSORY NOTES—NOT FULLY "PAID UP" WITHIN MEANING OF SECTION 9366 G. C.

SYLLABUS:

1. *The term "entire capital stock," as used in Section* 9366, *General Code, means capital stock subscribed for and issued, and not the amount authorized in the articles of incorporation or charter.*

2. *Capital stock of a life insurance company organized under the laws of another state which has been paid for in whole or in part by promissory notes of the subscribers thereto, is not fully paid up within the meaning of Section* 9366, *General Code.*

Columbus, Ohio, August 22, 1940.

Hon. John A. Lloyd,
Superintendent of Insurance,
State House Annex,
Columbus, Ohio.

Dear Sir:

This will acknowledge your communication with reference to the application of the S Life Insurance Company of Indiana for authority to do business in Ohio. With your communciation you have enclosed a letter from the S Life Insurance Company which sets forth briefly the history of the company and its capital structure.

It appears that this company was incorporated with an authorized capital stock of $200,000 of which $60,000 was paid in cash and subsequently within a period of eighteen months $40,000 was paid. Thereafter, on June 20, 1935, the authorized capital stock of the company was increased from $200,000 to $500,000 and subsequently on the 14th day of April, 1939, the authorized capital stock was increased from $500,000 to $1,000,000. $500,000

of the authorized capital stock has been subscribed for and approximately $237,000 has been paid in cash. It is stated in the letter of the company that the remainder of said subscriptions has been paid by notes executed by the individual purchasers of stock bearing five per cent interest, and that the stock is being held as collateral security for the payment of the notes.

Section 9366, General Code, referring to life insurance companies organized under the laws of other states of the United States, reads in part as follows:

> "Any such company shall not take risks or transact any business of insurance in this state, unless possessed of the amount of actual capital required of similar companies organized in this state under the provisions of this chapter, nor unless the entire capital stock of the company is fully paid up and invested as required by the laws of the state where organized. * * * "

It has been suggested that the words "as required by the laws of the state where organized" modify the words "fully paid up and invested" and that therefore if the capital stock of this company is fully paid up as required by the laws of the state of Indiana, this requirement of our statute is met. This section in its original form was part of "An act to regulate life insurance companies doing an insurance business in the state of Ohio," passed in 1872 and found in 69 O. L., 140, et seq., the particular portion in question being at page 155 and reading as follows:

> " * * * nor shall it be lawful for any such insurance company to take risks, or transact any business of insurance in this state, unless possessed of the amount of actual capital required of similar companies organized in this state under the provisions of this act; nor unless the entire capital stock of said company is fully paid up, and invested as required by the laws of the state where organized; * * * "

It will be noted that the statute in its present form is substantially the same as its prototype in the original enactment, except that the comma after the words "paid up" has been omitted in the subsequent amendments and revisions of the statute. However, I am of the view that the omission of this comma does not change the meaning of the language. In 59 C. J., 894, it is said:

> "A mere change of phraseology, or *punctuation,* or the addition, or omission of words in the revision or codification of statutes, does not necessarily change the operation or effect thereof and will

not be deemed to do so unless the intent to make such change is clear and unmistakable." (Emphasis mine.)

It would therefore seem that the words "as required by the laws of the state where organized" modify only the word "invested" and have no connection with and do not limit the words "fully paid up." Section 9366, General Code, should therefore be construed as requiring the entire issued capital stock of such a company to be fully paid up before such company may be admitted to do business in this State, and even though the laws of the state of organization of such company permit it to do business without its capital stock's being fully paid up, Section 9366, General Code, would bar its admission to this State.

It is therefore necessary to determine whether the capital stock of the company in question is fully paid up and this at once raises another subsidiary or auxiliary question, viz., does the term "capital stock" as used in Section 9366, General Code, mean "authorized capital stock" or "issued capital stock?" In 5 Thompson on Corporations (3rd Ed.), Section 3412, page 242, it was said:

"It must be borne in mind that the mere fixing of the amount of the capital stock in the articles of incorporation does not in fact create capital stock; at most it is a mere designation of what the capital stock may or shall be. In this form it is no more than a potentiality. It cannot be regarded as being in the nature of property until persons have, by writing or otherwise, agreed to take and pay for the same in money or property. No financial enterprise can be accomplished by the mere statement of the amount of the capital stock in the articles of incorporation. What is thus termed capital stock is only a statutory authorization with the means of creating the same. In remarking on the nature of the capital stock a federal judge said: 'The corporate powers of the company were conferred for the express purpose of creating stock as a means of constructing a railroad. As well might the route for the road designated be called a railroad, as to call the corporate means of creating stock, stock. In like point of view, it is important to call things by their right names. This is especially necessary when the effect of the exercise of corporate powers is to be determined. *Stock can be created only by contract,* whether it be in the simple form of a subscription or in any other mode. There must be an agreement to take the stock, and nothing short of this can create it. This imparts to the stock the quality of property which before it did not possess. It is called capital stock in the character, because the corporate capacity to create it is given. The term "stock," as used in the charter, before it is taken by subscription, means nothing more than a power in the directors to receive subscriptions for stock.' *This principle is further illustrated in a case where it appeared that the statute used*

> *the expression, 'the whole capital stock,' and it was held that in the connection in which the words were used it meant the capital stock actually subscribed for and issued, and not the amount named in the articles of association."* (Emphasis mine.)

The rule thus stated would seem to indicate that the term "capital stock," as used in the Ohio statute, means the stock for which the company has received subscriptions and which has been issued to the subscribers. Tested by this rule, this company has $500,000 of capital stock.

It remains to be determined whether this $500,000 has been "fully paid." It appears that a great many of the subscribers have not paid for their stock in cash but have given their notes for at least a part of the subscription price. As a general rule, payment of an obligation must be made in money or property and the acceptance of the promissory note of the debtor is not ordinarily considered payment.

In 31 O. Jur., 177, Section 74, it is said:

> "The general rule is that the delivery and acceptance of commercial paper of the debtor, by the creditor, does not of itself amount to payment, in the absence of an agreement that it shall be so considered. It is merely evidence of the debt, or an acknowledgment or memorandum of the amount ascertained to be due, or, as is sometimes said, conditional payment."

In the absence of an agreement between the subscriber and the corporation, the acceptance by the corporation of the subscriber's note for his unpaid subscription would not be considered payment, and for the reasons hereinafter set forth, it is believed that even if a life insurance company make such an agreement with the subscribers to its capital stock and accept such note in payment of subscriptions, nevertheless such stock is not fully paid within the meaning of Section 9366, General Code, supra.

The business of insurance is effected with the public interest and is subject to legislative regulation and control. A foreign insurance company does business in Ohio not by right but by grace and is permitted to do business in this state only upon compliance with the terms and conditions imposed by our laws. See Verducci vs. Casualty Company, 96 O. S., 260; State, ex rel. Sheets vs. Etna Life Insurance Company, 69 O. S., 317 and State, ex rel. Allstates Insurance Company vs. Bowen, 130 O. S., 347. The purpose of the statute in question is to secure ample capital for life insurance companies doing business in this state. It was enacted for the protection of the policy-

holders and other creditors of such corporation. The capital stock of a corporation and the unpaid stock subscriptions are considered a trust fund for the benefit of its creditors. If the promissory notes given by subscribers are considered to be absolute payment of the subscription, the nature of the debt owed by the subscribers to the corporation is transferred from that of an unpaid stock subscription to that of an ordinary debt, and is no longer part of the trust fund to which the creditors can look.

In Sawyer vs. Hoag, 17 Wall., 610, the defendant had subscribed to stock of a fire insurance corporation and paid for same, and immediately borrowed the money back from the corporation and gave his note therefor. The corporation became insolvent and the assignee in bankruptcy brought an action against the subscriber claiming the subscription was unpaid. He claimed that he was an ordinary debtor of the corporation and attempted to plead as a set-off a claim which the corporation owed to him. The Supreme Court denied the right of set-off, holding that the stock subscription had never in fact been paid as against the creditors of the corporation and that the transaction was a mere subterfuge and that the subscription could be collected. At page 621 it was said in the opinion of the court by Mr. Justice Miller:

> "It is the change of the character of the debt from one of a stock subscription unpaid to that of a loan of money. The debt ceases by this operation, if effectual, to be the trust fund to which creditors can look, and becomes ordinary assets with which the directors may deal as they choose.
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> And this was precisely what was designed by the parties. It divested the claim against the stockholder of its character of a trust fund, and enabled both him and the directors to deal with it freed from that charge.
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> It was, therefore, a regular system of operations to the injury of the creditor, beneficial alone to the stockholder and the corporation.
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> We do not believe we characterize it too strongly when we say it was a fraud upon the public who were expected to deal with them.
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> The result of it was that the capital stock of the Company was neither paid up in actual money, nor did it exist in the form of deferred installments properly secured."

In Williams vs. Brewster, 117 Wis., 370, 93 N. W., 479, it was said

by Marshall, J., at page 382 of 117 Wis. (93 N. W., 483), concerning the case of Sawyer vs. Hoag, supra:

> "The legal effect of the federal case cited is that stock cannot be considered fully paid as regards the rights of creditors, merely because the corporation, with or without an agreement to the effect, accepts the subscribers promissory note for the amount of his subscription. We have no hesitancy in deciding that such must have been the legislative purpose in enacting section 1765, Rev. St. 1898. The purpose was to protect creditors. If stockholders can avoid its effect by giving their promissory notes for subscriptions for stock, by changing the mere evidence of their indebtedness, leaving the condition of the corporation as regards ability to pay its creditors the same as before, a very convenient way exists to enable corporations to pay dividends without any capital having been paid in, regardless of consequences. A construction of the statute that would permit such a practice, it seems, would convict the legislature of putting upon the statute books an absurd piece of legislation. The words 'capital stock fully paid in' contemplate an actual payment of the subscription, not the mere giving of a promise to pay it. It need not necessarily be paid in money, but it must be paid, not merely promised to be paid—the liability to the corporation be actually extinguished by an addition to its assets of either money or property of a money value, equivalent to the subscription of indebtedness. Leaving out of view the value of the subscription liability as an asset of the corporation and the stock as an asset of the subscriber, payment of capital to the corporation means adding something thereto that will make the corporation, to the extent of the liability extinguished richer than before, and a subscriber for stock correspondingly poorer."

A corporation may not therefore as against its creditors accept notes from a subscriber to its capital stock in absolute payment thereof, nor can such stock be regarded as fully paid within the meaning of Section 9366, General Code.

You are therefore advised that the S Life Insurance Company of Indiana, upon the facts contained in its letter to you, may not be authorized to do business in this state.

Respectfully,

THOMAS J. HERBERT,
Attorney General.