Individual Personal Liability of Bank Directors for Negligent and Excess Loans

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Introduction

The wholesale failure of banking institutions throughout the country during this period of deflated land values and other securities, has brought into prominence and is now developing that field of the law dealing with the liability of the directors and officers of defunct banking corporations.

Thousands of bankers and "figure head directors" have fallen heir to civil litigation by virtue of their titular offices. The service of summons, to many of these, is a thunder-bolt from a clear sky and their first knowledge that the law imposes an affirmative duty upon them as bank officers and directors. It is that duty and the resultant civil liability for the neglect of same that forms the avowed purpose of this article.

No field of the law can be approached as an exact science, and that part of the law dealing with directors liability is no exception, necessitating a general survey of the basic principles underlying that liability,—principles which should be matters of common knowledge and have been too infrequently called to the attention of our bankers and general public.

The civil liability of bank directors for making bad loans may arise either under the common law or under special statute such as the excess loan statutes in force in many jurisdictions. We will therefore discuss this liability under two heads:

I. THE COMMON LAW LIABILITY

It may be stated as a general proposition that there is a common law liability apart from statutory liability, of
bank officers and directors for failure and neglect in the performance of their duties.¹

An early New York decision gives us the reason for holding directors liable for their negligence under the common law, in the following language:

“When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he expects, and has the right to expect, that the trustees or directors who are chosen to take his place in the management and control of his property, will exercise ordinary care and prudence in the trusts committed to them . . . . “When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such degree of care and prudence, and it is a gross breach of duty—crassa negligentia—not to bestow them.”²

A. Actions—How Liability May Be Raised

1. Actions at Law

The question of who may raise this liability and how it may be raised has led to a great diversity of opinion but the general rule seems to be, that no action at law can be maintained against bank directors by a creditor or depositor for mismanagement and negligence that may be a wrong against the corporation and of consequent damage to the creditor.³

The reason for the rule, as set out, is the lack of privity or contractual relation between the parties. The courts have reasoned that the duty to exercise diligence is one owed to the corporation and not to the creditors whose injuries are incidental. The case of Zinn v. Mendel,⁴ following the above rule, also gives an additional reason for not

² Hun v. Carey, 82 N. Y. 65 (1880).
⁴ 9 W. Va. 580 (1876).
permitting the depositor to bring an action at law for damages in his own right:

"Upon consideration, it seems to me that, if actions for the cause stated in the plaintiff's declaration against directors of banks and other corporations were sustained by the courts of law, it would be highly detrimental to the public interest and not conducive to justice. Thoughtless impulse and passions might for a time justify it, but sober, sound thought and reason must and will condemn it; if not at once, surely in a reasonable time. Banking institutions and other corporations are essential to the welfare and prosperity of the country and these institutions cannot generally be operated save through the agency of directors, and if the directors of such institutions were held liable at law to the creditors thereof in damages for every act and negligence in the management and disposition of the moneys and property of the corporation, of which the corporation might lawfully complain, responsible men could not be found who would take upon themselves the perils and dangers of the position."

The rule that the depositor cannot bring an action at law in his own right against the directors of the bank for negligence, is not without its exceptions, and there are a few cases that hold a contrary opinion. In those instances the actions have been maintained on the theory that the directors are trustees for creditors. Notable among those decisions is the case of Delano v. Case,5 which was an action by a general depositor against the directors of the bank for negligence. The court stated in opinion:

"For the ordinary negligence of directors, they are responsible alone to their principal, but, for such gross negligence or incompetency as shows a reckless disregard of their duty to care for and protect the funds committed to their charge, we think they are directly responsible to the depositor."

2. Equity Actions

The same conflict of opinion is found regarding suits in equity in the creditor's own name, but it is generally conceded by the courts that depositors may bring a suit in equity in the nature of a creditors' bill to charge the directors

5 17 Ill. App. 531 (1885).
with fraud, mismanagement and negligence. Of course the receiver of an insolvent bank, being the principal, no question of privity of contract or tort arises when he sues the directors of the defunct bank for their negligence or losses on negligent loans. Such suits are brought properly in equity and are usually in the nature of an accounting.

It may be concluded then, that, apart from any statutory liability, there is a duty imposed upon bank directors, the neglect of which may result in a direct personal liability for the loss occasioned by mismanagement or negligence in handling of banking affairs, which liability may be extended to include losses on loans negligently made.

B. The Common Law Duty of Bank Directors

The question of what the common law duty of bank directors is, and what constitutes a breach of it, becomes important to a discussion of the subject. The duty imposed upon the director under the common law, the existence of which has been pointed out, is to act in good faith and with ordinary care and diligence as ordinarily prudent men would exercise with reference to the conduct of such a moneyed institution.

Thompson defines the duties of directors, in his *Commentaries on the Law of Private Corporations*, as follows: "By accepting the position, they assume a capacity to manage the business of the corporation, and impliedly undertake to use as much diligence and care as the proper performance of the duties of their office requires, and to give the enterprise the benefit of their best care and judgment. They are bound to manage the affairs of the company with the same degree of care and prudence which is generally exercised by business men in the management of their own affairs, and the fact of the service without compensation does not permit a less degree of activity. They must be diligent and careful in performing the duties they have undertaken, and imprudence and negligence can-

7 3 R. C. L. 488.
not be excused on the ground of ignorance or inexperience, or the honesty of intention.”

The following, from a late decision of the Nebraska Supreme Court, summarizes the relation in which a bank director stands to the public. The court states the following with reference to his duties as an officer of the bank:

“Banks themselves are prone to state, and hold out to the public, who compose their boards of directors. The idea is not to be tolerated that they serve as merely gilded ornaments of the institution, to enhance its attractiveness, or that their reputations should be used as a lure to customers. What the public suppose, and have the right to suppose, is that those men have been selected by reason of their high character for integrity, their sound judgment, and their capacity for conducting the affairs of the bank safely and securely.

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“Directors of banking corporations occupy one of the most important and responsible of all business relations to the general public. By accepting the position and holding themselves out to the public as such, they assume that they will supervise and give direction to the affairs of the corporation... It is the duty of the directors to know the condition of the corporation whose affairs they voluntarily assume to control, and they are presumed to know that which it is their duty to know, and which they have the means of knowing.”

C. The Degree of Care

The degree of care required of directors in their handling of banking affairs, has been generally stated as, that care which men of ordinary prudence would exercise under similar circumstances and that in determining such degree of care the restrictions of the banking laws and usages of business would be taken into account. The question resolves itself into one of fact to be determined by all the circumstances in each given case, inasmuch as each case is one that must be tried upon its own peculiar facts and surrounding circumstances. It is impossible to definitely define what

8 THOMPSON, LAW OF PRIVATE CORPORATIONS, § 1268.
11 Rankin v. Cooper, 149 Fed. 1010 (1907).
is expected of directors as a general rule, but a few broad
principles of liability have been developed and are applied
by the courts to these particular types of cases, which prin-
ciples are reflected by a consideration of various decisions.

Foremost, perhaps, among defenses commonly urged by
bank directors are the defenses of ignorance, inexperience,
and honesty of intention. The general impression among
directors seems to be that they are not liable for anything
but actual fraud, or some affirmative act of mal-administra-
tion. But the bank director is liable also for acts of negli-
gent omission. The courts have held that the absence of
improper motive or desire for personal profit on the part
of the directors is no defense to an action for negligent
management and loss on loans negligently made.12 They
have even gone so far as to hold that a director cannot be
excused from liability when he voluntarily remains in office,
although his advanced age has made it difficult for him to
properly perform his duties as a director.13 It has been fur-
ther suggested by some courts that if a director is not able to
influence the rest of the board in properly conducting the
affairs of the bank that he should sever all connections with
the bank in order to avoid further personal liability.14 The
Bank director will not be permitted to be shielded from lia-
bility because of ignorance of wrong-doing and especially
where such ignorance is the result of gross inattention.15

Another common defense advanced by bank directors sued
for derelictions in duty is predicated on the fact, that, in
the conduct of banking affairs, it is necessary to delegate
powers of management to a certain degree. The directors
taking advantage of this circumstance then claim that they
are unaware of the negligent acts of the cashier, or one to
whom such powers have been delegated. This defense has

13 Stone v. Rottman, 183 Mo. 552 (1904); Ford v. Taylor, 4 S. W. (2d)
938 (Ark. 1928).
been exploded by the courts. It has been held that where it is necessary to delegate powers of management in any degree, it is the duty of the directors to exert a reasonable supervision of management and that their want of knowledge of the wrong-doing of officers in the bank will not excuse the directors from liability if it is the result of their gross inattention.

Thompson, in his *Commentaries on the Law of Private Corporations*, has the following to say on this subject:

“They (directors) are not permitted to evade their power or important duties and their supervision must be such as would enable them at all times to know the general financial condition of the corporation and to check or prevent any imprudent or dishonest conduct in officials... They are bound to know the character and habits of the officers whom they employ... and they are responsible for losses resulting from the wrongful acts or omissions of other directors or agents, where such loss was a consequence of their own neglect of duty, either in failing to supervise the company's business with proper attention, or in neglecting to use proper care in the appointment of such agents.”

Excuses on the part of negligent directors such as ill health, non-residence and solicitation are common among defenses. These excuses as defenses have also been denied by the courts. Their practically unanimous opinion is, that the directors are not excused from liability for the making of bad loans, or other negligence by virtue of the fact that they live several hundred miles away from the bank.

The court said in the case of *Bowerman v. Hamner*:

“It would be a reproach to the law to permit his residence at a distance from the location of the bank, a condition which existed from the time he first assumed the office of director, to serve as an excuse for his utter abdication of his common law responsibility for the conduct of its affairs and for the flagrant violation of his oath of office when it resulted in loss to others.”

The same theory has been applied to the excuses of ill health and solicitation.

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16 THOMPSON, op. cit. supra note 8.
18 MORSE, BANKS AND BANKING (1928) Vol. 1, § 128.
One further common defense among directors sued for their negligence and resultant loss on bad loans is that they did not examine the records of the bank and had no knowledge that any negligent loans were ever made, or that such loans had never been called to their attention, as the records of such loans had never been submitted for their examination. The directors cannot be heard to say that they were ignorant of the facts surrounding the making of the loan when its existence is shown by the books and records of the bank, and where it would have been known to them but for their negligence or inattention to the business and failure to familiarize themselves with the records of the bank. It is the duty of bank directors in the absence of statute to examine papers and effects of the bank, to familiarize themselves with its business and affairs, and know to whom the principal lines of credit have been extended.\footnote{Spongberg v. First National Bank, 18 Ida. 524, 110 Pac. 713, Ann. Cases, 1912 -A, 95 and note; Gund v. Ballard, 80 Ne'. 385, 114 N. W. 420 (1907).}

Concluding this discussion regarding some of the general principles that the courts have applied to suits against directors on their common law liability for negligent management of bank affairs, including the making of poor loans, we may observe that, even upon a cursory examination of the law and the duty imposed upon directors by the common law, the office of bank director is one of responsibility; that those accepting the office of directors assume at the same time the legal responsibility to diligently manage the affairs of the bank, falling short of which they may become personally liable for loss on loans and other damage caused by their neglect of duties. The idea, or notion that the office of a bank director is a passive, honorary position desirable for social standing and prestige in the community, is not tolerated by the law and most certainly should not be countenanced by the public.
II. Excess Loans

A. General

In several states a statutory liability has been imposed on bank directors for making excess loans. These statutes governing state banks are similar to the federal excess loan statute governing loans in national banks. The constitutionality of legislation along this line has been questioned at different times, but to no avail, it having been decided that such legislation does not deprive the bank directors of equal protection of the law. In our consideration of the excess loan statutes we will not dwell, therefore, upon constitutional questions, but rather turn to a discussion of the judicial interpretation of these statutes.

Many practical problems of pleading confront the lawyer in bringing suit against the directors of a bank for excess loans. One must keep in mind the fact that directors are not released from their common law duty to administer affairs of the bank by statutory provisions regarding excess loans. It has also been held that suits against the directors for excess loans are properly subjects of equitable jurisdiction and that a prayer for an accounting is appropriate and pertinent for the purpose of ascertaining the amount necessary to be recovered to pay losses and to adjust the liability of the several directors, some of whom may have served as directors longer or at different times than others. It has been held that a bill in equity to obtain an accounting and decree for money lost by negligence may be framed so that if the evidence fails to establish statutory

20 See discussion of cases questioning the constitutionality of legislation fixing liability of directors collected in Note, 57 A. L. R. 888.
23 Shannon v. Mabley, 143 S. E. 582 (Ga. 1928).
negligence, but establishes common law negligence, a decree may be entered accordingly and thus the necessity for a resort to a second suit is avoided.\textsuperscript{24} The inference might be drawn therefore that in states where an excess loan statute exists a suit could be framed in equity to include both negligent loans and excess loans. This procedure would seem to be further borne out by the following general proposition of law:

"A complaint is not deemed to unite several causes of action simply because it sets forth several grounds on which the defendant might be liable in respect to the same transaction. Several grounds for liability may be assigned in one count. Thus in an action against the directors or stockholders of a corporation, seeking to charge them personally with the debt of the corporation the complaint is not to be deemed as uniting several causes of action in one count, because it sets forth several grounds on either of which the defendants would be liable."\textsuperscript{25}

If the foregoing rule is correct, then, as a matter of pleading, common law and statutory grounds for liability set out in the same suit is permissible, and the same loan might be declared upon as both negligent under the common law and excess under the statute.

As we discuss the question of statutory liability for excess loans it may be well also to keep in mind the fact that the liability of a director survives against his estate,\textsuperscript{26} and that the living directors of a bank may be joined with the executors of deceased directors in a suit for negligence and excess loans.\textsuperscript{27}

\textsuperscript{24} Bowerman v. Hamner, \textit{op. cit. supra} note 1; Gamble v. Brown, 29 Fed. (2d) 366 (1928). See: Chesbrough v. Woodworth, 224 U. S. 72, 61 L. Ed. 1000 (1916), for joinder of parties defendant, holding that action may be brought against one, or all the defendants where the liability for excess loans is made both joint and several. \textit{Cf.} Curtis v. Metcalfe, 265 Fed. 293 (1918), where a separate statement against each director was held necessary where there are a great number of directors holding office at different times.


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B. Statutes

A comparison of some of the excess loan statutes now in force in different jurisdictions will serve as a basis for drawing certain general conclusions concerning their construction, and for the further purpose of showing that the cause of action with its different elements of liability created under these several statutes, is essentially the same.

The Kentucky excess loan statute 28 reads:

"If any director or directors of any bank shall knowingly violate or permit any officer or employee of the bank to violate any provisions of the laws relating to banks, the directors so offending shall be jointly and severally individually liable to the creditors and stockholders for any loss or damage resulting from such violation."

The same statute then sets a limit for loans as follows:

"No bank shall permit any of its stockholders, or any person, company, or firm . . . to become indebted to it in a sum exceeding twenty per cent of its capital stock actually paid in and its actual amount of surplus unless such borrower pledge with it good and sufficient collateral security or execute to it a mortgage upon real or personal estate which at the time is of more than the cash value of such loan or indebtedness above all other encumbrances; and if the borrower is a director or officer of such bank it shall not be permitted to become indebted to it in excess of ten per cent of its paid up capital stock without securing the excess . . . and in no event shall the indebtedness of any person, company, or firm including in the liability of the company or firm the liability of the individual members thereof, exceed thirty per cent of its paid up capital and actual surplus."

The South Dakota Statute 29 on the subject reads:

"Every officer and director of any bank shall be held personally liable for all excessive loans made by his bank, in such amount as such loan may be in excess of the amount limited by law, and his liability thereon shall be the same as though such paper was endorsed by him, but to the extent only of the excessive amount . . . ."

The Nebraska Statute 30 is as follows:

"No corporation transacting a banking business in this state shall directly or indirectly loan to any single corporation, firm or individual,

30 §§ 8-150, COMP. STS. OF NEB. (1929).
including in such loans all loans made to the several members or share holders of such firm or corporation, for the use and benefit of such corporation, firm or individual, more than twenty per cent of the paid up capital and surplus of such bank . . . In case of such violation, every director who participated in, or knowingly assented to the same, shall be held liable in his personal and individual capacity for all damages which the bank, its shareholders, or any other person shall have sustained in consequence of such violation.”

Missouri and Ohio have similar statutes to those above set out.

The Federal Statute 31 provides for a loan limit of ten per cent in the following language:

“If the directors of any national banking association shall knowingly violate, or knowingly permit any of the provisions of this title, all the rights and privileges and franchises of the association shall be thereby forfeited . . . And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person shall have sustained in consequence of such violation.”

The purpose of the enactment of all these statutes is pointed out in the case of Wickliffe v. Turner, 32 where the court says:

“The statute was designed for the protection of the bank, its depositors, and stockholders, and must be liberally construed with a view to promote its purposes. That clause of the statute will in every case be applied which best protects the bank, its depositors and stockholders . . . The statute was designed to protect the bank against the risk of heavy loss by reason of an indebtedness being created to it from one person above the limits prescribed.”

C. Construction of Statutes

1. Prerequisites of Liability

The construction of state excess loan statutes by the state courts does not seem to be as well defined, or as well developed, as the law construing the Federal excess loan statute. This is the reason no doubt that in the construc-

31 U. S. Code Ann., Title 12, § 93, p. 212.
32 157 S. W. 1125 (Ky. 1913).
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From a comparison of the wording of the statutes heretofore set out it is evident that the liabilities imposed upon directors are similar. In other words the elements of liability, or necessary proofs and allegations going to make up a prima facie case against the directors are essentially the same. For instance, each statute contemplates as an element of liability, that the person sought to be charged must have been a duly qualified and acting director at the time of the statutory violation. It can be readily seen that no liability under the statute could be imposed upon one by virtue of his office who did not come under the express provisions of the statute.

In the second place the liability in most instances, including liability under the Federal statute, seems to have been made contingent upon the directors having some knowledge of the violations, whether it be actual or constructive. Knowledge is an essential element of liability under most statutes. The wording of the South Dakota statute, however, would seem to create a personal liability for excess loans precluding a possible defense based on lack of knowledge, or assent to the making of same. Generally, it may be concluded that a second element of the liability common to most excess loan statutes is the requirement of knowledge, assent, or actual participation on the part of the directors, charged with the liability under the statute, to the making of the loan in question. The rules developed in suits under the Common Law against directors for negligent loans and mismanagement have been applied to the statutory actions for excess loans. An examination of the opinion in
the late case of *White v. Thomas* 33 shows how closely these decisions, heretofore mentioned in this article, have been followed under statute where knowledge on the part of the director is made a necessary element of his liability.

"‘Directors cannot in justice to those who deal with the bank, shut their eyes to what is going on around them . . .

"‘It is the right and duty of the board to maintain a supervision of the affairs of the bank; to have a general knowledge of the manner in which its business is conducted and of the character of that business; and to have at least such a degree of intimacy with its affairs as to know to whom and upon what security its large lines of credit are given; and generally to know of and give direction with regard to the important and general affairs of the bank over which the cashier executes the details . . . The idea is not to be tolerated that they serve as merely gilded ornaments of the institution to enhance its attractiveness or that their reputation should be used as a lure to customers. What the public suppose, and have the right to suppose, is that those men have been selected by reason of their high character for integrity and sound judgment and their capacity for conducting the affairs of the bank safely and securely. The public act on this presumption and trust their property with the bank in the confidence that the directors will discharge a substantial duty . . . It is inconsistent with the purpose or policy of the banking act that its vital interest should be committed to one man without oversight and control.’"

In the third place, as a prerequisite of liability under excess loan statutes, is the proof that the line of credit sued upon is a single line of credit, as the statutory liability hinges upon the theory of an over extension of credit to a single firm or individual. In determining whether the line of credit sued on was extended to such single individual or firm, all the facts and circumstances must be taken into consideration, and any subterfuges by which a “dummy” borrower is extended credit for the use of another must be scrutinized carefully.

A fourth element of liability contemplated by all the statutes limiting loans in banks is the proof that the loan

33 37 Fed. (2d) 452 (C. C. A. 9th Cir., 1929).
sued upon is in excess of the statutory limit. This brings us to the all important question of, what is an excess loan? 84

2. Excess Loan Defined

At first glance the question of what an excess loan is, seems relatively simple, but closer investigation discloses the fact that the question may become quite complicated and involved. The rules laid down by the courts for determining what loans are excess are not difficult to follow, but their application often results in confusion and leads to a multitude of closely related problems of law. The courts themselves have not been consistent in their views as to what constitutes excess for which the directors may be liable. It is obvious that an excess loan is one that in itself exceeds the prescribed statutory limit, or one that added to the amount already owing to the bank from any given firm or individual causes the total line of indebtedness to exceed the statutory limit.

The definition of an excess loan is so closely related to the damages recoverable in any given instance that a discussion of the amount of damages for which the director is liable may in itself lend clarity to the definition.

a. Measure of Damages in the Case of a Single Excessive Loan

The construction given the Federal statute regarding the computation of damages in the case of a single excessive loan seems to represent the more recent holdings on the subject. In order to make clear what is meant by a single excess loan let us take as an example the instance where a


See Wickliffe v. Turner, op. cit. supra note 32, where it is held that it is not material whether the bank lends the money to a person and takes his note for it, or buys his paper from another, when the directors are sued under statute for overloaning the limit of indebtedness.

It has been held that the liability of an indorser can not be added to a line of loans to make it in excess of the statutory limit. Gamble v. Brown, op. cit. supra note 24.
bank has a capital stock of $100,000.00 and a surplus of $100,000.00, the two aggregating $200,000.00. Twenty thousand dollars then would be the limit under the Federal statute. If, then, the bank should as a single transaction, loan to a single firm or individual thirty thousand dollars, that loan would be a single excess loan and the question arises whether the participating directors would be liable for only the loss on the ten thousand dollars constituting the excess above the limit prescribed, or whether they would be liable for the loss on the entire sum loaned. This proposition is discussed in the case of Corsicana National Bank v. Johnson and that discussion, as it affects the computation of damages on a single excessive loan, is in part as follows:

"According to the evidence, the $30,000, less discount, was paid out by the bank as a single payment; and, if the jury found it to have been loaned in excess of the statutory limit (whether in form one loan or two), it must be upon the ground that it was a single transaction... That being so it would follow that the entire amount disbursed by the bank was disbursed in violation of the law. The cause of action against a director knowingly participating in or assenting to such excessive loan would be complete at that moment, and entire; there would be no legal presumption that the borrowers would have accepted a loan within the limit, if their application of the excessive loan had been refused; nor that a director who in fact violated his duty as defined by law would if mindful of it, have loaned them even $20,000. To mitigate in his favor the damages resulting from a breach of his statutory duty by resorting to the hypothesis that, if he had not disregarded the law in this respect, he would have pursued a different course of action within the law, would be an unwarranted resort to fiction in aid of a wrongdoer, and at the expense of the party injured. Hence the entire excessive loan would have to be regarded as the basis for computing the damages of the bank."

This method of computing damages in the case of a single excess loan has been followed by the Federal courts and the case above mentioned is one of the leading decisions

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upon that subject. There are some decisions, however, in the state courts that arrive at a different conclusion and it has been argued in some instances that the directors are not liable on the whole indebtedness, which created the excess, but are liable only for the excess itself, even in the case of a single excess loan. 37

b. Measure of Damages in the Case of a Series of Loans

The question of liability in the case of a series of loans totaling more than the prescribed statutory limit has been evaded for the most part by the state courts. The question of the computation of damages where renewal notes include a series of old notes and in addition new principal combined with interest, has come before some state courts in construction of excess loan statutes, but was not passed upon squarely. 38 The Federal statute, however, has been construed with some degree of clarity and in a manner consistent with the Federal court holdings in reference to a single excess loan.

The difficulty of computation of damages where there are a series of loans is greatly enhanced, and the problems arising may be best illustrated by using an example. If under the Federal statute the loan limit of a given bank was $20,000.00, that being 10% of the paid up capital stock and surplus, and on a certain date there was due and owing from A to the bank an aggregate of $17,000, representing a series of loans that had been renewed from time to time, and on that date a new loan of $7,000 was made to A, at which time the old notes and the new loans were renewed and evidenced by a new note of $24,000, the question arises as to what extent the participating directors are liable on this transaction. The Federal courts have construed the

37 Wickliffe v. Turner, op. cit. supra note 32; Sturges v. Barton, 8 Ohio St. 215 (1858).
statute governing National Banks to create a liability for the entire amount of the $7,000 loan, this being the loan that was in itself excessive when added to the amount already owing from A to the bank.\textsuperscript{39} It will be observed that this is consistent with the Federal court holdings in the case of a single excess loan. The court in the case of \textit{McRoberts v. Spalding}\textsuperscript{40} in laying down the rule for computation of damages where there was a series of loans cites the \textit{Corsicana National Bank} case:

“It is held in the case of Corsicana National Bank v. Johnson that the entire sum loaned plus the interest and less salvage, should be treated as the damages sustained, and not merely the excess above what lawfully might have been loaned when the entire excess loan formed but a single transaction. The inference in this case being that, if, in good faith and in the ordinary course of business, the defendants made a loan equal to the amount authorized and later, while this loan remained unpaid, as a separate transaction, unlawfully loaned additional money in excess of the prescribed limit, the damage legally attributable to their violation of the limiting provisions would be the amount of the excess loan, and not the full amount.”

\textbf{So both in the case of a single excess loan and of a series of excess loans, under the Federal statute, the liability of the directors is determined, not by the amount that is over the statutory limit, but by the entire amount of the loan that is excess.}\textsuperscript{41}

\textbf{c. Renewal Notes}

There are many variations of the question of damage computation that may be presented. Both the state courts and the Federal courts have declared that a renewal of notes, which adds only interest bringing the total line of credit to exceed the statutory limit, does not constitute a new loan for which directors can be held under the statute prohibit-

\textsuperscript{39} \textit{McRoberts v. Spaulding, op. cit. supra} note 12.
\textsuperscript{40} \textit{Op. cit. supra} note 12.
\textsuperscript{41} \textit{Adams v. Clarke, op. cit. supra} note 22; \textit{McRoberts v. Spaulding, op. cit. supra} note 12; \textit{Gamble v. Brown, op. cit. supra} note 24; \textit{Anderson v. Galley, 33 Fed. (2d) 589 (1929); Rankin v. Cooper, op. cit. supra} note 36.
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ing excess loans. It has also been held that if money in the bank was misapplied prior to the time the directors took office, or without their knowledge or approval, that subsequent renewals of such paper upon which nothing is added but accrued interest, does not amount to a new loan for borrowed money. The theory adopted by the courts in this holding is that a renewal is not a loan, but merely an extension of the time of payment.

The courts conclude that as a matter of policy, once a bad loan has been made the directors must do everything possible to preserve the assets and are not only warranted in taking a renewal, but are obligated to do so if it is the only way to protect the bank assets. It may be concluded, then, that in order to prove a loan excessive under the statute it must be shown that new principal was loaned by virtue of which the line of credit was made to exceed the statutory limit.

d. Salvage and Interest

Regarding the subject of damages, it may be stated as a general rule, that salvage on notes may be deducted in mitigation of damages. The rule adopted by the Federal courts in determining the extent of the directors liability for excess loans is "the entire sum loaned plus interest and less salvage." But it has been held that while the directors are entitled to the salvage in mitigation of damages for excess loans, that the burden is on the director to show the salvage since he becomes immediately liable for the whole amount, and further, that the director cannot require

43 See cases referred to in note 42, supra.
a receiver to apply collections made on excess loans in reduction of the excess, and their exoneration if the amount is reduced within the legal limit. The view has been taken that the bank has no right to receive the paper where an excess loan is involved, and if such paper is left among the assets of the bank by the directors it is only in the nature of salvage.

Even among the decisions of the Federal Courts, there is great confusion and many conflicting opinions regarding the question of interest. This is due to the fact that there is a diversity of opinion among the courts regarding the running of the Statute of Limitations. Some decisions are to the effect that the directors are liable for interest on the amounts found due on excess loans from the date of the transaction. These decisions are for the most part traceable to the courts that have adopted the view that the liability of the director begins and the limitation statute runs, from the making of the loan. Another line of decisions allows interest on the amounts found due, from the date of the institution of suit against the directors by the receiver. These courts reason that the statute of limitations does not begin to run until the directors go out of control of the bank's affairs. So we see that the question of interest really hinges upon the courts' construction of excess loan statutes in regard to the statute of limitations.

3. The Statute of Limitations

Attention has already been called to the fact that there is division of authority regarding the statute of limitations and suits against bank directors for excess and negligent

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46 Adams v. Clarke, op. cit. supra note 22.
47 Anderson v. Gailey, op. cit. supra note 41.
loans, the one view being that the cause of action accrues at the time of making the loan, and the other that the statute does not begin to run until the directors go out of actual control of the bank and its business. While these two lines of decisions are in direct conflict with each other, they seem to be in accord on the proposition that the defendant directors become immediately liable for the entire amount of the excess loan when made. One line of decisions on the subject of limitation of actions, then more or less logically concludes that if the cause of action arises with the making of the loan, that the statute should begin to run in favor of the bank directors at that time. The Corsicana National Bank case is an example of this reasoning:

"The damage as well as the injury was complete at that time (the time of making the loan) and the bank was not obliged to await the maturity of the notes, because immediately it became the duty of the officers or directors who knowingly participated in making the excessive loan to undo the wrong done by taking the notes off the hands of the bank and restoring to it the money that had been loaned. Of course, whatever of value the bank recovered from the borrowers on account of the loan would go in diminution of the damages; but the responsible officials would have no right to require the bank to pursue its remedies against the borrowers or await the liquidation of their estates. The liability imposed by the statute upon the directors is a direct liability, not contingent or collateral."

The same view was taken by the court in the case of Anderson v. Gailey:

"Whether the conduct of the majority is wise and diligent under all the circumstances, or wrongful, is often a close question, and controversy over it needs the quieting of limitation as much as any other controversy. Without it, business men would hesitate to become bank directors... I conclude that the alleged acts of making excess loans or loans insolvent when made more than four years before suit was brought are barred... No fraud or fraudulent concealment appears in these, and failure to use diligence to discover and enforce liability does appear."

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The result of applying the rule as above set out in many instances would not be equitable to the depositors and creditors of the failed banking institution when put in receivership. Combined with this fact there is the possible exception in the law regarding the running of the statute of limitations after the appointment of a receiver to the effect that when a receiver is appointed process of law is suspended and the statute of limitations against ordinary actions does not apply, lapse of time being important only as it tends to show laches or unreasonable delay,53 which may form the basis of another line of decisions in opposition to the one pointed out.

The case of Adams v. Clarke54 attempts to distinguish the one before the court and the holding in the Corsicana National Bank case, on the facts, by arguing that in the Corsicana National Bank case the directors did not continue in full control of the bank up to the time it closed while in the instant case they constitute the entire board of directors up until the closing of the bank. Part of the opinion follows:

"This suit was commenced on August 6, 1925, and the majority of the excess loans involved were made more than three years prior thereto. The cause of action in such a case is deemed to have arisen when the excess loan was made. Corsicana National Bank v. Johnson (C. C. A.) 218 F. 822; Id. 251 U. S. 68, 40 S. Ct. 82, 64 L. Ed. 141. And apparently the bank is chargeable with knowledge disclosed by its records and the information possessed by its directors. Curtis v. Connly, supra. But here, during the entire period in question, defendants not only held a majority of the capital stock but constituted the entire board of directors. As trustees in exclusive control of the bank's affairs, they cannot take advantage of inaction for which they alone are responsible. Morse On Banks (5th Ed.) §125 . . .

"In Cooper v. Hill (C. C. A.) 94 F. 582, Corsicana National Bank v. Johnson, 251 U. S. 68, 40 S. Ct. 82, 64 L. Ed. 141, and Curtis v. Connly, 257 U. S. 260, 42 S. Ct. 100, 66 L. Ed. 222, it is pointed out that the defendants sought to be charged did not continue in

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full control of the bank up to the time it closed, but that, though under no disability, it failed to take action during the limitation period. In the last case, commenting upon a suggestion that 'the defendants stood in a fiduciary relation to the bank,' the court said: 'But they were strangers to it when they left the board, more than six years before this suit was brought.' Our conclusion is that the action was not barred as to any of the excess loans involved."

So the case of Adams v. Clarke, while it arrived at a different decision than did the Corsicana National Bank case, did not directly disapprove the reasoning of that case, but tried to get away from its doctrine by attempting to distinguish the two cases on the facts.

The case of Schilling v. Parman strikes squarely at the doctrine of the Corsicana National Bank case and without attempting any distinction on the facts, takes issue with that decision:

"There is, however, some confusion in the authorities as to whether the statute of limitations begins to run in favor of the directors at the time the excess loan is made, or not until there is a loss to the bank or a change in the management. It is said by Mr. Justice Pitney in Corsicana National Bank v. Johnson, 251 U. S. 86, 40 S. Ct. 82, 64 L. Ed. 141, that the cause of action against an offending director accrues at the time the loan is made, and the bank is not required to wait the maturity of the note or the liquidation of the borrower's estate before bringing a suit. The statement of the learned justice, although it does not seem to have been necessary to a decision of the case before the court, is of course entitled to very great respect. If, however, the statute of limitations commences to run, regardless of the circumstances, at the time of the loan, it will enable the directors of a bank to escape liability for their wrongful acts if they remain in control of the bank during the time prescribed by the statute. Directors are not trustees of an express trust, but they are trustees of an implied or resulting trust, created by operation of law on their official relation to the bank. Cooper v. Hill (C. C. A.) 94 F. 582. Their possession and control of the bank is the possession and control of their cestui que trust. As long as that relation exists, there can be no assertion of an adverse claim by the bank, or a suit brought to remedy the wrong.

55 35 Fed. (2d) 780 (1928).
“As at present advised, I am of the opinion that the better doctrine is that in equity the statute of limitations will not run in favor of the directors of a bank who have the control and management of its affairs while they remain in control. National Bank of Commerce v. Wade (C. C.) 84 F. 10; Rankin v. Cooper (C. C.) 149 F. 1010.”

There has been a great deal of criticism of the holding in the Corsicana National Bank case and other cases supporting that rule. The recent and more modern doctrine is at variance with the holding and no doubt the decision in the case of Schilling v. Parman marks the present trend in both state and Federal Courts as to the statute of limitations respecting the liability of bank directors for statutory excess loans. With the increasing number of suits by receivers of defunct banking corporations there is now a tendency of the courts to take away the shield of the statute of limitations from the directors in favor of their innocent and blameless depositors. Certainly this is the more equitable rule.

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