

INSURANCE:
DIVIDENDS:

Section 375.380, RSMo 1969, making it unlawful for insurance companies to pay dividends except from surplus profits arising from the business, prohibits the payment of dividends by such companies where there is no earned surplus or undistributed profits.

September 15, 1970

OPINION NO. 173

Mr. William Y. McCaskill
Superintendent
Division of Insurance
Jefferson Building
Jefferson City, Missouri 65101



Dear Mr. McCaskill:

This official opinion is issued in response to the request contained in your letter concerning the legality of paying dividends by a Missouri life insurance company from funds other than earnings from the conduct of its business. More specifically, the question presented is as follows:

"In view of the above circumstances, we request your opinion as to the propriety and the legality of a cash dividend to preferred stockholders in the amount of \$32,000 paid by Continental Security Life Insurance Company during the period January 1, 1969 to June 30, 1969, or at any other time during which the company is operating at an underwriting loss."

Briefly, the facts outlined in your letter may be thus stated:

The Continental Security Life Insurance Company is a life insurance company organized and operating under the laws of Missouri. During the calendar year 1968 the company sustained an underwriting loss of \$232,973.49, and during the period of January 1 to June 30, 1969, the company sustained a further underwriting loss of \$37,197.26. Between December 31, 1968 and June 30, 1969, the company declared and paid a dividend in cash to its preferred stockholders amounting to \$32,000. At the time of payment of the dividend the financial statement of the company disclosed that there was capital paid up of

Mr. William Y. McCaskill

\$263,000, paid-in and contributed surplus of \$1,682,000 less unassigned surplus of (\$1,224,026.28) or remaining total surplus of \$457,973.72, being the difference between the two surplus figures.

The company was organized in 1962, and, according to its annual statements, a net loss from operations was sustained in each year to and including the calendar year 1968 and during the operating period of January 1 to June 30, 1969. At the time of payment of the dividend to preferred stockholders the company did not have a surplus created by earnings or profits from the operation of its insurance business. It is apparent, therefore, that the dividend was paid from "paid-in and contributed surplus" as disclosed in the company's financial statements.

At the outset it should be observed that the State of Missouri has a comprehensive code regulating insurance companies and the insurance business, and any question concerning the operation of a Missouri life insurance company must be considered in the special light of legislation and regulations affecting these companies as distinguished from ordinary business corporations. The purposes and the intent underlying the insurance code have been described by the Supreme Court of Missouri in *State v. Hall*, 330 Mo.1107, 52 S.W.2d 174, where it was said:

"The legislative power to authorize, supervise, regulate, and liquidate insurance companies rests on the interests of the public in the insurance business. It is conceded that the state may through administrative officers supervise and regulate insurance companies in aid of solvency. If so, it has the power to protect those interested, in the event of insolvency. It is a valid exercise of the police power through administrative officers. *State v. Matthews*, 44 Mo.523; *State ex rel. Mackey v. Hyde*, 315 Mo.681, 286 S.W.363, loc.cit.365. The power was first exercised in 1869 by the enactment of an Insurance Code intended to protect policyholders, stockholders, and the public. Laws 1869, p.23. The original Code and amendments thereto indicate an intention to regulate the business from beginning to end, thereby protecting individual and public interests. The enactment of this comprehensive Code made the state a real party in interest. The superintendent of insurance is the administrative officer in charge of that interest, and courts are without authority to interfere with his administration of the Code." (Emphasis supplied)

In referring to the Superintendent of Insurance in relation to his administration of the Insurance Code, Section 374.040, RSMo 1969 states that it shall be his duty:

Mr. William Y. McCaskill

" * * * generally to do and perform with justice and impartiality all such duties as are or may be imposed upon him by the laws regulating the business of insurance in this state and to perform those duties imposed upon him in such a manner as to be in the best interests of and protect the general public, policyholders, insurance companies, and the officers, directors and stockholders thereof; * * * "

Thus, it is apparent that any interpretation of the provisions of the insurance laws must take into consideration the fact that the state and the general public as well as the policyholders and the stockholders have vital interests in the conduct and operation of insurance companies.

Chapter 375, RSMo 1969, sets forth provisions applicable to all insurance companies. Section 375.380 of this chapter states as follows:

"1. It shall not be lawful for the directors, trustees or managers of any insurance company to make any dividend, except from the surplus profits arising from their business, nor for any company to solicit or do new business, when its assets are less than three-fourths of its liabilities."

The language "to make any dividend, except from the surplus profits arising from their business," as used in this statute or language similar thereto has been considered by the courts in several instances. It is apparent that "to make any dividend" is considered as meaning to pay any dividend. *Western & Southern Fire Ins. Co. v. Murphey*, 156 P.885, 56 Okla.702; *Randall v. Bailey*, 23 N.Y.S.2d 173; *People v. San Francisco Savings Union*, 13 P.498, 72 Cal.199; *People ex rel. North American Trust Co. v. Knight*, 89 N.Y.S. 72, 91 App.Div.120.

As to what constitutes "surplus profits" the cases appear to be in conflict. *Randall v. Bailey*, *supra*, and *Western & Southern Fire Ins. Co. v. Murphey*, *supra*, indicate that such may be created by the stockholders or from earnings. On the other hand, *People v. San Francisco Savings Union*, *supra*, and *People ex rel. North American Trust Co. v. Knight*, *supra*, hold that surplus profits mean an excess of receipts over expenditures arising from the operation of business. We think the better view is represented by the latter authorities as well as those which follow.

The precise question is whether payment of a dividend by the company from its "paid-in and contributed surplus" constitutes payment from "surplus profits arising from their business" within the meaning of the statute. Section 375.380, RSMo 1969.

Mr. William Y. McCaskill

There is a vital difference between "paid-in and contributed surplus" and "surplus profits arising from . . . business". The difference is the same that exists in an ordinary understanding of the matter as well as in the accounting and legal sense between paid-in, surplus or contributed surplus on the one hand, and earned surplus or undistributed profits on the other.

As stated by the court in *Winkelman v. General Motors Corp.*, 44 F.Supp 960,996 (S.D.N.Y.), the surplus account of a corporation represents the net assets in excess of all liabilities, including capital stock. That surplus may be "paid-in surplus" as where the stock is issued at a price above par, it may be "earned surplus" as where it is derived wholly from undistributed profits, or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the corporation's fixed property.

Likewise, in *U.S. v. Zion's Savings & Loan Assn.*, 313 F.2d 331,335, (10th Cir.) the court held that "paid-in surplus" is a surplus which has accumulated by the sale of stock at more than par, and "earned surplus" is the surplus resulting from the profitable operations of the company.

In the case of *In re Lloyd's Estate*, 12 N.Y.S.2d 292,297, 171 Misc.219, it was held that the fund produced by the action of corporate directors in reducing the number of shares of stock so as to create a surplus remains "contributed capital" and constitutes neither "earnings" or "earned surplus" which is the product of earnings, the fruits of contributed capital.

The Supreme Court of Massachusetts in *Commissioner of Corporations & Taxation v. Filoon*, 38 N.E.2d 693,700, 310 Mass.374, held that "accumulated profits" may be described as "earned surplus" or "undivided profits" to distinguish them from "capital" in the broad sense, including "paid-in surplus" or "capital surplus" and they represent property earned by the corporation as distinguished from property invested in the corporation by shareholders, and they may include earnings resulting from capital transactions as well as earnings resulting from ordinary operations of the corporation, and they are in the nature of "income" of such corporation.

The Supreme Court of Missouri in *Leggett v. Missouri State Life Ins. Co.*, 342 S.W.2d 833,899, stated:

" * * * 'The surplus or profits of a mutual life insurance company is the sum remaining out of its gross income after deducting the reserve, dividends, and the losses and expenses; it arises from savings on the assumed rate of mortality, from the excess of interest received over the assumed rate, from the loading for expenses, and the gains from lapsed and surrendered policies; all such items go to make up the surplus, or the so-called net profits of the business, and it is from this source that all

Mr. William Y. McCaskill

so-called dividends and returns to the policyholders, in excess of the face of the policy are made. * * * "

These cases illustrate the distinction between paid-in surplus contributed by the stockholders and surplus earned from operation of the business. Here the surplus was not created by amounts remaining out of the company's gross income because nothing remained, rather an underwriting loss was incurred each year. We are dealing with surplus which was created by money paid in by the stockholders rather than a surplus resulting from the profitable operations of the company.

One of the principal purposes of the insurance laws of Missouri is to give protection to the policyholders and the general public against dilution of the assets of insurance companies by improper distributions of capital (including paid-in surplus) to shareholders.

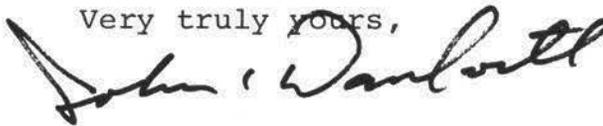
We believe that the fund from which dividends may be paid under Section 375.380, RSMo 1969, must be one earned by the corporation as distinguished from funds invested in the corporation by its stockholders. Accordingly the statute prohibits the payment of dividends under the circumstances involved in the present case.

CONCLUSION

Therefore, it is the opinion of this office that Section 375.380, RSMo 1969, making it unlawful for insurance companies to pay dividends except from surplus profits arising from the business, prohibits the payment of dividends by such companies where there is no earned surplus or undistributed profits.

The foregoing opinion, which I hereby approve, was prepared by my assistant, John E. Park.

Very truly yours,



JOHN C. DANFORTH
Attorney General