BUILDING AND LOAN: Class B assets may borrow money from Class A.

March 7, 1941

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FILED

Honorable J. W. McCammon, Supervisor
Bureau of Building and Loan Supervision
Jefferson City, Missouri

Dear Sir:

This Department is in receipt of your request for an official opinion, which reads as follows:

> "A request has been filed with this office by Ray W. Hunt, secretary, Sedalia Savings and Loan Association, Sedalia, Missouri, for the permission of the supervisor to allow the Sedalia Savings and Loan Association, a Missouri Corporation, to loan a portion of its cash on hand, upon the security of a note signed by directors, to the Class B assets of the Sedalia Savings and Loan Association.
>
> "The Class B assets of the association represent assets segregated in 1937 by the directors of the association and placed in a participating reserve fund for the sole purpose of orderly liquidation under the direction and management of the Sedalia Savings and Loan Association's board of directors. This segregation was carried out under the terms and provisions of Section 5593, Laws of Missouri, 1935.

"The Class A assets of the association at the time of reorganization, by segregation, were acceptable to the Federal Savings and Loan Insurance Corporation and an insurance of share accounts certificate was issued to the Class A portion of the association. It is at this time a going concern.

"In the conducting of the liquidation of the Class B assets, the directors found it necessary to borrow money from a local bank to cover unpaid taxes on real estate owned. The insured portion of the association has cash on hand not now in use and the directors feel that they should be permitted to loan a reasonable amount to the Class B and receive the prevailing interest charge rather than have the Class B pay such charge to an outside agency.

"We have reason to believe a similar situation will develop in other cases of segregation where there is not a conveying of Class B assets to three trustees and we respectfully request your opinion as to whether or not such a loan could be made by the insured association to the Class B assets."

Section 8210, R. S. Mo. 1939, provides that a building and loan association in its by-laws may provide that any loans and other assets of doubtful value may be placed in a reserve fund, which fund shall remain separate from the other assets of the association and shall be liquidated. "Participating reserve shares" are issued to stockholders, representing their pro rata share in this fund.

Section 8213, R. S. Mo. 1939, provides that surplus funds of a building and loan association may be loaned "to others than stockholders on the security of prime unencumbered real estate."

Section 8227, R. S. Mo. 1939, provides by its by-laws that any building and loan association shall have the power to borrow not more than an aggregate amount equal to twenty-five per cent. of its capital. It will be seen that this reserve fund, while still a part of the assets of the association and still under the control of the directors, is a fund separate from other assets. The directors and officers are to liquidate this fund and are to conduct such liquidation separate and apart from the other business of the association. The question presented by your request is whether this reserve fund may borrow money from the Class A portion of the association which is a going concern. The closest analogy that we can find in law to this setup is where two corporations have common members on their board of directors, that is, the members of the board of directors of one corporation are the same as those of a second corporation.

In Fletcher on Corporations, Vol. 3, page 345, it is said:

> "So in Missouri it is held that a sale of property by one corporation to another having the same directors cannot be complained of by the stockholders where the sale was for full value and in no way fraudulent."

However, as pointed out in Cummings v. Parker, 250 Mo. 427, l. c. 440, 157 S. W. 629:

> "It is uniformly held that directors of corporations stand in the relation of trustees to the corporate property. Hence when the issue on trial on complaint of a shareholder is whether a transaction should be avoided or profits accounted for in dealings between corporations having interlocked boards of directors, or in dealings with such directors anent corporate property, such dealings will be judicially eyed with jealousy and sternness to search out and correct lurking mischief."

In Manufacturers Savings Bank v. O'Reilly, 97 Mo. 38, 10 S. W. 865, the court said:

> "The mere fact that these defendants were directors and stockholders in the selling and purchasing corporation did not make the sale absolutely void."

In view of the above authorities it will be seen that the trust fund or Class B fund may borrow money from the going association representing the Class A shares, if such transaction is in no way unfair or fraudulent. Such transaction is not void but only voidable and will not be set aside if it clearly appears to be just and fair in every respect. We wish to point out, however, that this loan must be on the security of prime unemcumbered real estate as required by Section 8213, supra.

Conclusion

It is, therefore, the opinion of this Department that the reserve fund set up under Section 8210, R. S. Mo. 1939, may borrow money from the going association representing the Class A shares, if such transaction is just and fair in every respect, and such loan cannot be set aside unless it is shown that it was unfair or entered into in bad faith or that fraud was present.

Respectfully submitted,

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APPROVED:

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