areas required to be investigated and to be the subject of a report and recommendation by the investigating agency.

Violations of Burns' 22-2401 and 22-2405, *supra*, are punishable by the provisions of the act of which they are a part and such violations have no place in determining whether the investigating agency should or should not approve consent of minor parents.

Burns' 22-2401 and 22-2405, *supra*, are not intended to cover a physician placing a child for adoption in cooperation with an attorney.

**OFFICIAL OPINION NO. 33**

May 26, 1958

Mr. Joe McCord, Director
Department of Financial Institutions
410 State House
Indianapolis, Indiana

Dear Mr. McCord:

This is in reply to your request for my Official Opinion in answer to the following question:

"May a state chartered credit union refund to borrowing members a portion of the interest paid by such members and, in addition, pay the regularly declared dividend to such members on their investment in shares?"

It appears that the Indiana Credit Union League is advocating this practice and counsel for that organization has submitted a Memorandum in support thereof. The argument in that Memorandum has been carefully considered and will be discussed throughout this opinion:

I

Said Memorandum first states:

"The subject of interest refunds or patronage dividends is not covered in the provisions of our Indiana Credit Union Law. As far as I am able to determine,
the law neither expressly permits nor prohibits the payment of such refunds."

The above quotation is unquestionably a correct statement in the sense that the subject of such payments is not expressly mentioned; further, said Memorandum does not contain any case authority in support thereof and from my research it appears that case law on this subject is lacking. It should be noted that credit unions may not be organized under the Indiana General Corporation Act, Acts of 1929, Ch. 215, Sec. 2, as found in Burns' (1948 Repl.), Section 25-201. Such corporations as may be organized under the Indiana General Corporation Act have very broad general powers to conduct any legitimate type of business (except those specifically excluded) including the performance of acts convenient or expedient to carry out the purposes for which they are formed, as provided by the Acts of 1929, Ch. 215, Sec. 3, as found in Burns' (1948 Repl.), Section 25-202.

By contrast, state-chartered credit unions derive their existence and powers from Part VI, Article I of the Indiana Financial Institutions Act, being the Acts of 1933, Ch. 40, Secs. 296 to 323, as amended, as found in Burns' (1950 Repl.), Sections 18-2201 to 18-2228 inclusive. The powers of credit unions are enumerated in precise terms of restriction in the Acts of 1933, Ch. 40, Sec. 303, as amended, as found in Burns' (1957 Supp.), Section 18-2208; relative to implied powers granted, that section concludes as follows:

"(j) To exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." (Our emphasis)

Therefore, although the above-quoted subsection of the Credit Union Law itself provides a statutory basis for the right to exercise implied powers, that subsection also limits such to "incidental power as shall be necessary or requisite * * *." The tenor of the Memorandum on behalf of the Indiana Credit Union League is directed toward attempting to show that such interest refunds or patronage dividends would not be detrimental to any interested person, but said Memorandum makes no claim that such payments are necessary or
requisite. Nor am I able to conceive in what manner such payments could be considered as necessary or requisite, no matter how desirable this practice might be. Therefore, since interest refunds or patronage dividends are not specifically authorized, that practice could only be justified as an implied power if such were "necessary or requisite to enable it to carry on effectively the business for which it is incorporated."

II

Said Memorandum relies primarily upon the provisions of Section 310 (b) and (d) of the Indiana Credit Union Law, being the Acts of 1933, Ch. 40, Sec. 310 (b) and (d), as amended, as found in Burns' (1950 Repl.), Section 18-2215, (b) and (d), which provide:

"* * * Unless the by-laws shall specifically reserve any and all of the duties to the members, it shall be the special duty of the directors: * * *

"(b) To determine, from time to time, rates of interest which shall be charged on loans.

* * *

"(d) To fix the maximum number of shares which may be held by and the maximum amount which may be loaned to any one [1] member; to declare dividends and recommend amendments to the by-laws. * * *"

As a prelude to discussing this section, it should be observed that Section 310, supra, is not one creating additional powers of the credit union as a corporation. Rather this section concerns certain phases of the internal management of the credit union, such as designating its officers and providing the duties of the directors. This section then must be interpreted not independently, but together with the entire act. Referring again to the section by which the credit union derives its powers, the Acts of 1933, Ch. 40, Sec. 303 (g), as amended, as found in Burns' (1957 Supp.), Section 18-2208 (g), provides as follows:

"A credit union shall have the following powers:

* * *
“(g) To issue shares of stock of such kinds and classes and upon such terms, conditions, limitations, and restrictions and with such relative rights as to each kind or class of stock as may be stated in the by-laws of the credit union and as shall be approved by the department, but no kind or class of stock shall have preference or priority over the other to share in the assets of the credit union upon liquidation or dissolution or to the payment of dividends except as to the amount of such dividends and the time for the payment thereof as may be provided by the by-laws.” (Our emphasis)

Unless such authority be reserved in the by-laws, the power to determine rates of interest charged on loans is vested in the directors, subject, however, to statutory limitations. However, when such rate is unconditionally fixed at a definite percentage as required, interest payments received on loans are an element of income of the corporation over which the individual borrower has no control. The only situation in which the borrower could compel an actual interest refund or rebate would be if the borrower had paid interest in excess of the fixed rate specified in the loan contract through some error or oversight in isolated cases, so that the borrower could rely upon his contract, claiming such excess as belonging to him.

Except for isolated erroneous overcharges, all interest payments are corporate income and being so, the type of payments urged by the Indiana Credit Union League cannot be justified as interest refunds. Such payment, if permissible, would constitute some form of declared dividend. Under normal business practices and in the absence of specific statutory authority providing limitations, such patronage dividends would seem to be most illogical, being definitely preferential in favor of debtors and detrimental toward investors and creditors.

If the type of patronage dividends, payable only to borrowers, were permissible, such practice would result in some depletion of the corporation’s income available to it for expenses, investments, further loans to members and for the payment of dividends to shareholders, and would require some authorized overt act by the corporation. Such a practice would admittedly affect the relative rights of shareholders, which (if
otherwise authorized) would necessitate such a provision in the by-laws subject to approval by the Department of Financial Institutions, as provided by statute.

Such a practice would, therefore, appear to be contrary to the spirit of Section 303 (g), supra, which generally disfavors preferences or priorities between kinds or classes of shares. While that section intimates that the amount of dividends may vary according to the classification of stock when provided in the by-laws and approved by the Department, such refers to classes of shares, i.e., varying types of share contracts and not to individual circumstances relating to whether the shareholder is or is not indebted to the credit union.

Further, this practice (if not subject to regulation) would seem to be contrary to the purposes for which credit unions are formed. Their object is to promote thrift by encouraging the accumulation of savings by members and to provide funds available for loans to members. The basic concept of a credit union is that its corporate income go toward the payment of its operational expenses, the maintenance of the minimum statutory requirements for its reserve fund, the payment of dividends to those members whose savings have made such income possible and the further enlargement of reserves for future loans to members in times of their financial crisis or need. For a recently organized or small credit union, possibly having insubstantial reserves, to pay patronage dividends might actually decelerate the accumulation of reserves to such extent that the credit union would not be able to fulfill its purpose to make needed loans to its members in times of financial distress.

As to such credit unions which may have excessive surpluses, it would appear that the fixed interest charge in the past may have been excessive or higher than needed so as to justify reduced interest rates on new loans,—thus beneficial to future borrowing members. Such fact might also indicate the justification for increased dividends to all shareholders, in which past and present borrowers would participate with all other members upon a share-holding basis.

III

It is suggested by said Memorandum that a special patronage dividend account might be established into which a portion
of the earnings could be paid prior to vesting in the undivided profits accounts; further, that if the Board of Directors does not have the authority to declare a borrowers' dividend, that such be voted by the shareholders at their annual meeting.

From the conclusion of a former Attorney General, as contained in 1939 O. A. G., p. 18, it would seem that such patronage dividend account could not be established without amending the Credit Union Law. In the 1939 Official Opinion, it was held that at that time an undivided profits account could not be established, because the law then did not so provide. That portion of the law has since been amended, being the Acts of 1933, Ch. 40, Sec. 318, as amended, as found in Burns' (1950 Repl.), Section 18-2223, which now provides as follows:

“All entrance fees and charges shall, after the payment of the organization expenses, be known as reserve income, and shall be added to the reserve fund of the credit union. At the close of the fiscal year, there shall be set apart to the reserve fund twenty [20] per cent of the net income of the corporation which has accumulated during the year. The members, at any annual meeting, may increase the proportion of the profits which is required by this section to be set apart to the reserve fund or to decrease it when it equals ten [10] per cent of the paid-in capital of the credit union. The reserve fund shall belong to the corporation and shall be held to meet contingencies and shall not be distributed to the members except upon dissolution of the corporation. Any losses incurred by such credit union shall be paid out of and charged against such fund. Any credit union may also carry an undivided profits account and accumulate such account until the total amount thereof shall equal ten [10] per cent of the paid-in capital of the credit union. Any amount carried in the undivided profits account may, from time to time, upon order of the board of directors, be transferred to the reserve fund or may be used for the payment of dividends or necessary operating expenses.”

In view of the above-quoted section and further because a special patronage dividend account would not be necessary or requisite, for legal, business or accounting purposes, an amend-
ment to the Credit Union Law would seem to be required in order that such a fund be authorized, especially since it would be used to pay a dividend resulting in an unusual and illogical type of preference.

Attention is further directed to the provision concerning the payment of dividends, being the Acts of 1933, Ch. 40, Sec. 319, as found in Burns' (1950 Repl.), Section 18-2224 which provides as follows:

“At the close of any fiscal year or at the end of any quarter thereof or any month a credit union may declare a dividend from the net earnings. *Dividends shall be paid on all fully paid shares outstanding at the close of the fiscal year* but in lieu thereof dividends may be paid, at the option of the credit union, at the end of any quarter of any fiscal year or at the end of any month thereof but shares which become fully paid during the year shall be entitled to a proportionate part of such dividends calculated from the first day of the month following such payment in full.” (Our emphasis)

Even though *every* shareholder were to approve the payment of a patronage dividend, the payment of such dividends to borrowers would not be in harmony with the above-quoted section requiring that “dividends shall be paid on all fully paid shares,” notwithstanding that all shareholders would receive the regular dividend. *In effect, a patronage dividend would amount to an extra dividend payable only to borrowing members.* Further, the shareholders as a group cannot act beyond the scope of the statute, even though their action be unanimous. The payment of patronage dividends would also be prejudicial to creditors of the corporation who, in fact, would have a standing of preference as against shareholders in the event of dissolution.

IV

Said Memorandum directs considerable emphasis to the fact that the Federal authorities approve the payment of patronage dividends by federally-chartered credit unions; that this situation creates an inequity between federally-chartered credit unions and state-chartered credit unions, if the latter are not permitted to pay such patronage dividends. I have examined
this argument and from my research thereof find that the situation respecting federally-chartered credit unions confirms the idea that express statutory authority is required in order for state-chartered credit unions to have said power.

Reference to the Federal Credit Union Law and particularly to that Section of said Federal Act, as found in 12 U. S. C. A. § 1761 (c), as last amended in 1954, discloses that Congress has granted to the board of directors of federally-chartered credit unions the following express authority:

"* * * subject to the limitations of this chapter, determine the interest rates on loans and the maximum amount that may be loaned with or without security to any member and, subject to such regulations as may be issued by the Director, authorize an interest refund to members of record at the close of business on December 31 in proportion to the interest paid by them during that year." (Our emphasis)

The above-quoted portion of the Federal Credit Union Law not only is an express congressional authority for the payment of "an interest refund," but it should also be noted that the payment of such is also expressly subject to the regulations of the Director of the Bureau of Federal Credit Unions; in other words, in the case of federally-chartered credit unions this power is not one which may be exercised by the Board of Directors at will and without limitation.

It should also be pointed out that, concerning the 1954 amendment to the Federal Credit Union Law, House Report No. 1864, as found in U. S. Code Congressional and Administrative News, 1954, page 2456, stated the following:

"House Report No. 1864

"The Committee on Banking and Currency, to whom was referred the bill (S. 1665) to amend the Federal Credit Union Act, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

"GENERAL STATEMENT

"Section 1 of the bill amends section 11 (c) of the Federal Credit Union Act by providing that the direc-
tors of a Federal credit union may make an interest refund to borrowers if earnings of the credit union for the year are sufficient to justify such a refund. This authorization is permissive merely and the determination of whether or not a refund is to be made is left to the discretion of the board of directors, subject to reserve requirements of the Federal Credit Union Act and regulations to be issued by the Director of the Bureau of Federal Credit Unions.

"Section 12 of the Federal Credit Union Act provides that all entrance fees and fines provided by the bylaws and 20 percent of the net earnings of each year shall be set aside as a reserve before the declaration of any dividend. This section further provides that when the reserve reaches 10 percent of the total amount of members' shareholdings, no further transfer of net earnings to the reserve shall be required.

"A refund by a credit union of interest to borrowers could not be made except after reserve requirements have been met and there should be no refund until after the regular dividend is paid to all members. When these conditions have been met and net earnings are sufficient, then the bill would authorize a refund to the borrowers whose payment of interest made possible the earnings."

It thus appears that among the purposes of the 1954 Congressional amendment to the Federal Credit Union Law was that of expressly authorizing the payment of "an interest refund," which express authority would not have been necessary if that power had been previously established as an implied power of federally-chartered credit unions. This legislative history of the problem with respect to federally-chartered credit unions is most persuasive of the proposition that a comparable amendment to the Indiana Credit Union Law is necessary before state-chartered credit unions may have the authority to make such payments.

It may be noted that patronage dividends are most usually associated with the operation of a not-for-profit cooperative formed for the purpose of providing service to members at cost. Since actual cost often cannot be precisely determined in
advance, the payment of patronage dividends is a means by which to adjust overpayments for service previously rendered so that a member of such organization acquires such service for actual cost. Typical of such not-for-profit service cooperatives are corporations formed under the "Rural Electric Membership Corporation Act," being the Acts of 1935, Ch. 175, as amended, as found in Burns' (1951 Repl.), Section 55-4401 et seq. Corporations formed under said REMC Acts are organized as not-for-profit corporations for the purpose of promoting and encouraging the fullest possible use of electric energy by making such available to inhabitants of rural areas at the lowest cost consistent with sound economy and prudent management to members of such corporation, as provided in the Acts of 1935, Ch. 175, Sec. 2, as amended, as found in Burns' (1951 Repl.), Section 55-4402. In this type of corporation, inhabitants in the area served by the corporation become members not for investment purposes, but for the purpose of securing the service of electrical energy. It is specifically provided in the REMC Act, the Acts of 1935, Ch. 175, Sec. 17, as found in Burns' (1951 Repl.), Section 55-4417, that excess revenues and receipts not needed for the express purposes mentioned in that section "shall be returned to the members on a pro rata basis according to the amount of energy consumed, either in cash or in abatement of current charges for energy, as the board may decide."

Here again is an example in which a payment amounting to a patronage dividend is specifically authorized by the particular statute which governs corporations organized and operating under the REMC Act.

By contrast, credit unions are formed not solely for the purpose of affording services to members by way of loans, but also for the purpose of promoting savings by members and establishing a means by which they may invest with the expectation of a reasonable return for the use of their money; credit unions are, therefore, for-profit organizations and there are other interests to be considered than merely the interests of the users of credit union funds.

In view of the above, it is my opinion that a state-chartered credit union may not refund to borrowing members a portion of the interest paid by such members and, in addition, pay the
regularly declared dividend to such members on their investment in shares under the provisions of the Indiana Credit Union Law now in force; that, as in the case of federally-chartered credit unions, the Indiana Credit Union Law would have to be amended to grant such express authority, before patronage dividends may be permitted.

OFFICIAL OPINION NO. 34

June 3, 1958

Brigadier General John W. McConnell
Adjutant General of Indiana
212 State House
Indianapolis, Indiana

Dear Sir:

This is in reply to your letter in which you request my Official Opinion on the following:

"The Acts of 1915, Ch. 3, Sec. 1, as amended, as found in Burns' (1957 Supp.), Sec. 59-1009, offers several legal questions of extreme importance to personnel who have served and are serving in the military service of the State of Indiana and of the United States.

"Two of the more pertinent questions are as follows:

"1. Would service in the federally recognized National Guard of the United States, without active federal service, qualify an individual as a veteran within the purview and intent of the Act?

"2. A majority of the personnel of the Indiana National Guard are now required to serve with the Armed Forces of the United States for various periods of time, to-wit: Attendance at Service Schools operated by the regular establishment, active duty with the regular establishment for a period of two (2) years; active duty for training for a period of six (6) months, a similar eleven (11) week period, and a two (2) week annual active duty training period. Does this required service qualify participants as veterans within the purview and intent of the Act?"