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[\*1]

This is in response to your letter of July 24, 1980, to Dorothy Acosta of this Office concerning the application of Regulation O, 12 C.F.R. @ 215 et seq. (1980), implementing Title I of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, 12 U.S.C. @ 375b, to a proposed participation in a construction loan and a proposed issuance of a letter of credit by your bank to a limited partnership in which the corporate general partner is owned by a holding company which is owned by a director of your bank. You believe that Regulation O is inapplicable because the general partner has contracted away all policy-making powers to a management corporation with respect to the limited partnership's only asset (a hotel) and because all cancellations or amendments of the management contract must be approved by all of the participating banks.

As you know, Regulation O provides, among other things, that no member bank may extend credit to any of its executive officers, directors or principal shareholders or to any related interest of the person if the loan is preferential, or if the loan exceeds \$25,000 and has not received the prior approval [\*2] of a majority of the entire disinterested board. See 12 C.F.R. @ 215.4(a), (b) (1980).

"Related interest" is defined as "(a) a company that is controlled by a person or (2) a political or campaign committee that is controlled by a person or the funds or services of which will benefit a person." See 12 C.F.R. @ 215.2(k) (1980). "Company" is defined as "any corporation, partnership, trust (business or otherwise), association, joint venture, pool syndicate, sole proprietorship, unincorporated organization, or any other form of business entity not specifically listed herein. . . ." See 12 C.F.R. @ 215.2(a) (1980). "Control of a company" is defined to mean that a person directly or indirectly, or acting through or in concert with one or more persons

(i) Owns, controls or has the power to vote 25% or more of any class of voting securities of the company;

(ii) Controls in any manner the election of a majority of the directors of the company; or

(iii) Has the power to exercise a controlling influence over the management or policies of such company.

See 12 U.S.C. @ 375b (5); 12 C.F.R. @ 215.2(b) (1980).

The three-pronged test, you will note, is stated in [\*3] the disjunctive; if any of the three tests is satisfied, the company is deemed to be a "related interest" under Regulation O.

Your belief that Regulation O is inapplicable to the facts you describe appears to be based on the fact that the bank's director has neither a 25% equity investment in the limited partnership nor any management function in the entity. You believe that the limited partnership is not a related interest of the director, even though he indirectly owns 100% of the corporate general partner, because the general partner has contracted away the management of the limited partnership's only asset and the arrangement can only be altered with the approval of the lending banks.

It is my view, however, that for the purpose of determining the applicability of Regulation O, the limited partnership and the general partner which manages it should be viewed as one entity or company ("limited partnership company"). Under such an approach, ownership of the general partner can be analogized to ownership of one class of voting securities and ownership of the limited partnership to ownership of a separate class of voting securities. (While limited partners give up the right [\*4] to participate in management as a condition for the exemption from unlimited personal liability inherent in partnerships, limited partners almost always have the power to replace the general partner under certain circumstances, and in some states have voting rights similar to those accorded corporate shareholders.) Also, the function of the general partners in a limited partnership is similar to that performed by the directors and executive officers of a corporation. Using this approach, the first and second tests of control of a company (as well as the third) set forth in the statute and the regulation may be applied to a limited partnership.

The first test may be applied in the following mannerIf the officer, director principal shareholder ("insider") of the bank, directly or indirectly or acting through or in concert with one or more persons, owns, controls or has the power to vote 25% or more of either the general partner or the limited partnership interests, the limited partnership company is a related interest of the insider. Hence a loan to the limited partnership or to the general partner must conform to Regulation O (except that where the loan is to the general partner [\*5] for purposes unrelated to the limited partnership venture, the general partner need not be deemed to be a related interest of an insider who is a limited partner but has no interest in the general partner).

The second test may be applied in the following mannerSince the general partner's function is similar to that of a corporate board of directors, the ability to elect a majority of the directors of a corporate general partner or the ability to remove or replace the general partner (through ownership or control of a sufficient limited partnership interest) would render the limited partnership company a related interest of the insider possessing such ability.

Applying these tests to the facts you describe, it appears that both the first and the second tests of "control of a company" are satisfied, and there is no need to resort to the third test. As the sole owner of the corporation which is the sole owner of the corporate general partner, the director indirectly owns, controls and has the power to vote all of the stock of the general partner and thereby controls the election of its directors.

Even if it were necessary to resort to the third test of control in Regulation [\*6] O, it is our view that the limited partnership is a related interest. You state that management of the partnership asset has been contracted to an unrelated management corporation and that the participating banks must concur in any cancellation or amendment of the management contract. These facts are, however, irrelevant to the determination of whether the director exercises a controlling influence over the management and policies of the general partner. It is the power to exercise a controlling influence over the entity which is determinative, not how one chooses to exercise that power. The general partner decided to contract away the management of the partnership's only asset. The general partner will also decide to renew or terminate the management contract or to let it lapse. Nor is it relevant that the lending banks must approve the cancellation or amendment of the management contract. This is a temporary condition which lasts only so long as the loan is outstanding and is not inherent in the organizational structure of the limited partnership company.

It therefore appears that the participation of the [Material Deleted in Original] National Bank [Material Deleted [\*7] in Original] in the construction loan to the limited partnership is subject to the requirements of Regulation O, 12 C.F.R. @ 215.4(a) and (b) (1980). That is to say, its terms must not be preferential and it must receive the prior approval of a majority of the entire disinterested board of directors. Please also note that a standby letter of credit is considered an extension of credit under Regulation O. See 12 C.F.R. @ 215.3(a)(3) (1980).

As there are a number of banks participating in the financing of the project, I remind you that Title VIII of the Financial Institutions Regulatory and Interest Rate Control Act, 12 U.S.C. @ 1972(2), prohibits both preferential lending by a bank to insiders of another bank when there is a correspondent relationship between the banks and the opening of a correspondent account which there is a preferential extension of credit outstanding from one of the banks to the insiders of the other bank.

Very truly yours,

Roberta Walsh Boylan  
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