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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

**Interpretive Letter #808  
December 1997  
12 U.S.C. 84D2B**

November 3, 1997

Dear [ ]:

This responds to your letter to Leslie Linville, District Counsel, Midwestern District, in which you raised several questions concerning the aggregation of loans to borrowers that hold an undivided interest in feedlot cattle which are used as collateral for those loans. In your letter, you set forth three hypothetical situations concerning borrowers who hold undivided interests in cattle held in the same feedlot pen and ask whether the loans to such borrowers would be aggregated under the “common enterprise” test in the OCC lending limits regulation. 12 C.F.R. § 32.5(c). You are seeking this guidance because [

]’s business includes lending to persons holding undivided interests in feedlot cattle, which was the subject of an OCC examination. I apologize for the delay in responding to you, but I wanted a complete review of the issues raised by your letter.

**Hypothetical Feedlot Operations**

Your letter presents three hypotheticals for consideration and, I understand, is not intended to address the particular facts that were the subject of the previous examination. In the first hypothetical, you indicate that two borrowers, who each have 50% undivided interests in the same pen, are individual cattle feeders and that each borrows separately from the bank up to the bank’s lending limit to purchase and feed cattle in the undivided pen. Neither has another source of income from which the loans may be fully repaid, and the bank is relying on the proceeds the borrowers will receive from the sale of the cattle to repay the bank’s loans. As cattle are marketed, proceeds are divided equally between the borrowers.

The next hypothetical provides a slight variation to the basic fact pattern set forth in the first hypothetical. In the second hypothetical there are two borrowers who also own 50% undivided interests in the same pen. In this hypothetical, however, the borrowers contribute the same amount of feed to the livestock, the cattle are purchased and sold together and the borrowers issue separate checks to purchase the cattle and receive separate checks when the

cattle are sold. Each of the borrowers also has between 8% and 10% of income that is not derived from the sale of the livestock.

Finally, in the third hypothetical, one of the borrowers is the owner of the feedlot where the two borrowers hold cattle in undivided pens. As part of an agreement to put cattle in the feedlot, the owner of the feedlot agrees to purchase a 25% interest in each pen.

In evaluating these hypothetical questions, or in evaluating any transaction, all relevant facts and circumstances must be reviewed before a determination can be made as to whether the transaction constitutes a violation of the legal lending limits applicable to national banks. Thus, while I can give you some guidance on the hypotheticals presented in your letter, a full review of all of the facts surrounding any loan must be made on a case by case basis.

## **Discussion**

### **A. Lending Limits Requirements**

Loans and extensions of credit made by a national bank are subject to the lending limits set forth in 12 U.S.C. § 84. Generally, loans to any one person outstanding at one time must not exceed 15% of the unimpaired capital and unimpaired surplus of the national bank. See 12 U.S.C. § 84(a). In the case of loans secured by livestock, a national bank may loan an additional 10% of the bank's unimpaired capital and surplus to each borrower. See 12 C.F.R. § 32.3(b)(3).

Under certain circumstances, loans to one borrower will be attributed to another borrower, and those loans will be combined with a bank's loans to the second borrower when calculating a bank's compliance with its legal lending limits. For example, the combination rules applicable to national banks provide that loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed to be a borrower when (1) the proceeds of the loan are to be used for the direct benefit of the other person, or (2) when a "common enterprise" is deemed to exist between the persons. See 12 C.F.R. § 32.5(a).

Twelve C.F.R. § 32.5 sets forth four rules under which a common enterprise may be found to exist. First, a common enterprise will be deemed to exist where the expected source of repayment for the loan is the same for each borrower and neither borrower has another source of income from which the loan may be fully repaid. See 12 C.F.R. § 32.5(c)(1). Second, a common enterprise will be found where loans are made to persons who are related through common control and have substantial financial interdependence. See 12 C.F.R. § 32.5(c)(2). Third, a common enterprise will be found if separate persons borrow from a bank for the purpose of acquiring a business enterprise of which those persons will own more than 50 percent of the voting securities or voting interests. See 12 C.F.R. § 32.5(c)(3). In addition, a common enterprise will be found if the facts and circumstances of a particular transaction support that conclusion. See 12 C.F.R. § 32.5(c)(4).

## B. Prior Violations

Before discussing the hypotheticals, since you raised the issue in your letter, I would like to explain why certain loans in a previous examination of [ ] ("Bank") were cited as a violation. The violation cited in the Bank's examination report involved loans to [ Co. ] et al. and was based on the OCC's interpretation of what constitutes a "common enterprise" as defined in 12 C.F.R. §§ 32.5(c)(1) and (c)(4). The fact that ownership of the cattle by the borrowers was represented by an undivided interest was incidental to the violation. As stated in the Bank's report of examination, other relevant facts and circumstances contributed to the OCC's determination that a common enterprise existed, including: (a) common control as evidenced by a [ Co. ] corporate resolution that gave [ A ] and [ B ] management control with respect to monetary activities; (b) common management as evidenced by the fact that [ C ] managed the operations of both entities; and (c) common expenses shared by both entities.

## C. Application of Common Enterprise Test to Hypotheticals

In evaluating your hypotheticals, or in the examination process, the OCC does not combine loans to separate borrowers under the common enterprise test in 12 C.F.R. § 32.5 unless the facts and circumstances indicate the existence of some form of joint enterprise, such as a partnership or joint venture, or common control and substantial financial interdependence among borrowers. It is the responsibility of the bank's management to maintain credit files with sufficient documentation to support treating borrowers as separate entities.

In the first hypothetical, if we assume that each borrower's cattle are the sole source of repayment, the simple fact that the cattle are placed in a common feedlot pen does not by itself mean that the expected source of repayment is the same for each borrower for the purpose of the common enterprise test in 12 C.F.R. § 32.5(c)(1). As a result, the OCC would not combine these loans in the absence of other relevant facts and circumstances that would support the conclusion that a common enterprise existed.

In the second hypothetical, there are additional facts to consider. The cattle are purchased and sold together and the borrowers contribute the same amount of feed to the livestock. However, the borrowers also issue separate checks to purchase the cattle and receive separate checks when the cattle are sold and have between 8% and 10% of their income that is not related to the sale of the cattle. As I understand the second hypothetical, these facts alone would not constitute a common enterprise and, accordingly, the loans to the borrowers would not be combined under 12 C.F.R. § 32.5(c).

Additional facts and circumstances may, however, warrant combining loans. For example, a common enterprise would be deemed to exist if the facts and circumstances reflect common control and substantial financial interdependence among the borrowers. 12 C.F.R. § 32.5(c)(2). If the specific facts and circumstances of a feedlot operation reflected that the borrowers made purchase and sale decisions jointly and that each party was bound by the

business decisions of the other, a joint enterprise or partnership could exist and, accordingly, borrowers' loans would be combined.

As to the facts set out in the third hypothetical, I would also conclude that no common enterprise existed. The additional facts alone are, in my view, not sufficient to establish the existence of a partnership or otherwise constitute substantial financial interdependence among borrowers required under the common enterprise test. Under these facts, a common enterprise would not exist provided that business decisions are made separately by each owner. The fact that the feedlot owner, as an incentive to the borrower to place his cattle in the feedlot owner's lot, agrees to purchase interests in the borrower's cattle does not, by itself, constitute a common enterprise. Some other form of joint business decision making or financial interdependence would have to exist in order for the OCC to consider the arrangement a common enterprise.

### **Conclusion**

The conclusions above were based solely on the limited facts presented in the hypotheticals you posed. Additional relevant facts could, of course, result in different conclusions. Moreover, it is critical to recognize that, separate and apart from applicable lending limits, banks should avoid inappropriate concentrations of credit. A concentration of credit occurs in various situations, including when a bank makes a large portion of its loans to a single industry. Because of the risks presented when national banks lend more than 25 percent of their capital structure to a single industry, a national bank must have policies in place to address risks associated with undue concentrations of credit. Section 216.1 of the OCC Handbook for National Bank Examiners. Regardless of whether loans comply with the specific limitations of the lending limits standards, they must always be consistent with safe and sound banking practices, which include avoidance of excessive concentrations of credit.

I apologize again for the delay in this response. Please call me at (202) 874-5300 if you would like to discuss this further.

Sincerely,

/s/

Eric Thompson  
Director  
Bank Activities and Structure Division