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Interpretive Letters

938—January 18, 2001

12 USC 84(d)(2)(b)

Dear [ ];

This is in response to your letter of December 11, 2000. You have requested the Office of the Comptroller of the Currency's (OCC's) opinion as to whether certain loans made by [ ] ("bank") to two separate borrowing entities that are related through common ownership would be combined for lending limit purposes. Based on the information you provided in your letter and subsequent e-mails, it is my opinion that the two bank loans may be combinable for purposes of the legal lending limit during the year 2001 for the reasons set forth below.

I. Facts

The bank has two outstanding credit facilities totaling $14,620,000 to two limited liability companies managed by [ ] ("Inc."). [Inc.] is wholly owned by [A], [B], and [C].

The first credit is a $9,620,000 line of credit to [ ] ("West") for the purposes of land acquisition and site development. The acquired property is 67 acres located on the west side of Rt. [#] in *[City, State]*. West will develop the site for shopping center lots for sale to retailers. Repayment of the loan is expected from sale of the developed lots to various retailers, including [#1] and [#2]. The owners of West are:

[A]	29.5 percent
[B]	29.5 percent
[C]	29.5 percent
[D]	8 percent
[E]	2.5 percent
[Inc.]	1 percent

The loan is guaranteed by [Inc.], [A], [B], and [C]. West may use [ ] ("Inc. 2"), a wholly owned subsidiary of [Inc.], to perform the site development work.

The second credit is a $5 million line to [ ] ("East"). The purpose of this loan is to finance the land acquisition and site development phase of a two-phase shopping center development project. The second phase, involving the construction of retail stores on the site, will be financed through a conventional commercial construction loan. The phase two financing will not be underwritten until a majority of the leases with the major tenants are executed. [Inc.] currently has secured letters of intent from 100 percent of the major tenants (i.e., [#3], [#4], [#5], [#6], and [#7]). The expected source of repayment of the loan will be a take out by the phase two financing. East is owned by:

[A]	24.83 percent
[B]	24.83 percent
[C]	24.83 percent
[D]	22 percent
[E]	2.5 percent
[Inc.]	1.01 percent

The loan is guaranteed by [Inc.], [A], [B], and [C]. East may also use [Inc. 2] to perform the site development work.

The projected cash expenditures for East and West for the development period are as follows (in thousands):

Table 1—Projected cash e xpenditures for East, 2000–2001

Projected cash e xpenditures	2000	2001	TOTAL
Land Acquisition	4,709	0	4,709
Site development	1,500	8,700	10,200
Other	876	1,526	2,402
Total	7,085	10,226	17,311

Table 2—Projected cash expenditures for West, 2000–2002

Projected cash expenditures	2000	2001	2002	TOTAL
Land Acquisition	9,302	0	130	9,432
Site development	1,230	1,075	0	2,305
Other	468	419	60	947
Total	11,000	1,494	190	12,684

II. Legal Analysis

Generally, a national bank's total outstanding loans to one borrower may not exceed 15 percent of the bank's capital and surplus, plus an additional 10 percent of capital and surplus if the amount over the 15 percent general limit is fully secured by readily marketable securities.[1] A "borrower" includes a person who is named a borrower or debtor in a loan or extension of credit.[2] Also, loans

[1] *See* 12 USC 84(a); 12 CFR 32.2(a).

[2] 12 CFR 32.2(a).

to one borrower will be attributed to another person and both will be considered a borrower (1) when the proceeds are used for the *direct benefit* of the other person, or (2) when a *common enterprise* is deemed to exist between the persons.[3]

The proceeds of a loan to borrower will be deemed to be used for the *direct benefit* of another person and will be attributed to that other person when the proceeds, or assets purchased with such proceeds, are transferred to that other person, other than in a bona fide arm's-length transaction where the proceeds are used to acquire property, goods, or services.[4]

A *common enterprise* is deemed to exist when

(1) the expected source of repayment for each loan is the same and neither borrower has another source of income from which the loan and the borrower's other obligations can be repaid,
(2) the borrowers are related through common control and there is substantial financial interdependence between or among the borrowers,
(3) the borrowers use the loan proceeds to acquire more than 50 percent of a business enterprise, or
(4) the OCC determines that a common enterprise exists based on the facts and circumstances of particular transactions.[5]

Thus, in determining whether a loan to one borrower should be attributed to another borrower for lending limit purposes, one must apply each of the five loan combination/attribution tests set forth above—the one direct benefit test and the four common enterprise tests—to the specific facts of each loan relationship.[6]

[3] *See* 12 CFR 32.5(a). A guarantor is considered a "borrower" only if that guarantor is deemed to be a borrower under the direct benefit or common enterprise tests set forth at 12 CFR 32.5. *See* 12 CFR 32.2(a).

[4] 12 CFR 32.5(b).

[5] *See* 12 CFR 32.5(c).

[6] In addition to the general limit on loans to one borrower, there is an additional limit which applies to loans to a corporate group. *See* 12 CFR 32.5(d). Loans to a corporate group may not exceed 50 percent of a national bank's capital and surplus. 12 CFR 32.5(d)(1). A corporate group is defined as a person and all of its subsidiaries. *Id.* For the purpose of this rule, a corporation or limited liability company is a subsidiary of a person if that person owns more than 50 percent of the voting interests of the corporation or company. *Id.* This limit is independent of the general 15 percent limit on loans to one borrower set forth at 12 USC 84 and 12 CFR 32.3. This special limit applies to a corporate group regardless of whether loans to different members of the corporate group are combined for the general 15 percent limit.

A. Direct Benefit Test

According to your letter, loan proceeds for both the West and East loans will be used to acquire land and pay for site development costs. Some of those proceeds may be paid to [Inc. 2] for site development work. As long as payments to [Inc. 2] result from bona fide arm's-length transactions, the proceeds of the West and East loans paid to [Inc. 2] will not be attributed to [Inc. 2] under the direct benefit test at 12 CFR 32.5(b).

B. Common Enterprise Test # 1—Common Expected Source of Repayment

The expected source of repayment on the West loan is the sale of the developed lots to various retailers. The expected source of repayment on the East loan will be the proceeds of the phase two construction loan. Since the expected sources of repayment of the two loans are different, the loans will not be combined for purposes of the lending limit under the common enterprise test at 12 CFR 32.5(c)(1).

C. Common Enterprise Test # 2—Common Control and Significant Financial Interdependence

As stated above on page three, one way in which a common enterprise is deemed to exist is when:

(1) the borrowers are related through common control, and
(2) there is substantial financial interdependence between or among the borrowers.[7]

Borrowers are related through common control when one person or entity controls another, or two or more entities are each controlled by the same person or entity. For the purposes of this combination rule, control is deemed to exist if a person directly or indirectly, or acting through or together with one or more persons either (1) owns or controls 25 percent or more of the voting securities of another person, (2) controls in any manner the election of a majority of the directors or trustees of another person, or (3) has the power to exercise a controlling influence over the management or policies of another person.[8]

[7] *See* 12 CFR 32.5(c)(2).

[8] *See* 12 CFR 32.2(g). The term "person" as used section 32.2(g) means, among other things, a corporation, limited liability company, partnership or a trust. *See* 12 CFR 32.2(k).

Based on the information in your letter, West, East, [Inc. 2] and [Inc.] are related through the common control of [A], [B], and [C]. The next question, then, is to determine whether substantial financial interdependence exists between or among the control group members. Substantial financial interdependence is deemed to exist when 50 percent or more of one person's annual gross receipts or gross expenditures are derived from transactions with the other person. 12 CFR 32.5(c)(2)(ii). In determining whether substantial financial interdependence exists, we look at the borrower's gross receipts or gross expenditures "on an annual basis." When calculating a borrower's gross receipts or gross expenditures on "an annual basis," the relevant annual period will generally be the fiscal year used by the borrower.[9] Both West and East have a calendar year fiscal period.

Accordingly, if 50 percent or more of West's annual gross receipts or gross expenditures were received from or paid to East, [Inc.2], or [Inc.], then substantial financial interdependence would exist between West and such entity or entities, and loans to West would be attributed to, or combined with loans to, such entity or entities. Similarly, if 50 percent or more of East's annual gross receipts or gross expenditures were received from or paid to West, [Inc. 2], or [Inc.], then substantial financial interdependence would exist between East and such entity or entities, and loans to East would be attributed to, or combined with loans to, such entity or entities. The same analysis would apply to each member of the common control group.

Assuming that all of the site development costs incurred by West and East will be paid to [Inc. 2], those payments to [Inc.2] will represent 85 percent and 72