



Office of the Comptroller of the Currency

Interpretive Letter #731

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12 U.S.C. 24(7)14

July 1, 1996

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Re: Authority of [Bank] to Bid on The E-Z Pass System and to Perform the Contract by Means of an Operating Subsidiary

Dear []:

This responds to your letter, dated May 31, 1996, requesting confirmation of telephone conversations you had with attorneys on my staff regarding the referenced issue. Specifically, you discussed whether the bank would be authorized to enter into a contract with a public authority to operate on behalf of the public authority an electronic toll collection ("ETC" or "E-Z Pass") system. At this time, the bank has been pre-qualified as one of the bidders to obtain this contract. After the submission of the bid on July 15, 1996, but prior to executing a contract, the bank intends to file an operating subsidiary notification with the OCC. Because the bank is obligated to proceed with the contract, in the event the bank is the winning bidder, you requested confirmation in writing that the proposal is legally permissible for the bank and the operating subsidiary.

I. The Proposal

The bank would enter into a contract with a public authority that is acting on behalf of itself and other public authorities (the "Consortium" who are also members of the E-Z Pass Interagency Group) to implement the ETC system throughout the roadways and facilities operated by the Consortium. The bank would not be involved in financing the project, which is to be funded by the Consortium, nor would the bank own the facilities and equipment. The ETC system would allow toll road patrons to use a transponder tag attached to the vehicles to be scanned by reader equipment for patron account identification while the vehicles pass through reader-equipped toll lanes. The contract specifies the transponder and reader equipment manufacturer but the bidder is required to design, furnish and install the ETC equipment at modified toll plazas. The winning bidder is also required to design, implement and operate a customer service center ("CSC") to manage toll road patron "E-Z Pass accounts" for all Consortium members. The ETC system is intended to interact with the ETC systems of the E-Z Pass Interagency Group, including the road agencies of other states in the region, so as to introduce and standardize ETC in the region. The E-Z Pass system permits identification of toll road patron vehicles and the automatic debiting of the prepaid balance in their "E-Z Pass accounts" by means of information transmitted to and received from the CSC. The toll road patrons' "E-Z Pass accounts" are maintained by

the bank as agent for, and on behalf of, the Consortium. The winning bidder is required to provide the CSC computer system as a complete operational system with all necessary hardware and software components required for operation. As winning bidder, the bank would be expected to operate the CSC for an initial period of seven years.

The CSC must consist of a processing center and an adequate number of walk-in facilities to administer the "E-Z Pass accounts" (e.g., inquiries, new enrollments, payments, account statements), interface with Consortium and non-Consortium members' ETC systems (e.g., ETC toll transactions and exception and audit information), provide marketing services (e.g., deposits, return items, investments, reconciliations), and provide violation enforcement imaging processing. The CSC will handle customers by attended telephone, automated voice/response, mail, facsimile, and in person. In addition to operating the separate processing center, the bank intends to use its branches for walk-in facilities to provide information about the system, distribute "E-Z Pass account" applications, enroll customers and issue tags, accept payments, issue tag replacements, provide account balances and status information, and resolve disputed items. In the performance of these activities, particularly accepting payments for the "E-Z Pass accounts", the bank is acting as agent for the Consortium and not as principal. "E-Z Pass accounts" are not bank deposit accounts for the toll patrons, but instead represent a record of prepaid tolls collected and held by the bank on behalf of the Consortium. Under the terms of the E-Z Pass system, the toll patron's prepaid balance is reduced or debited each time the patron passes through a reader equipped toll plaza. Toll road patrons will periodically replenish their prepaid balances for their "E-Z Pass accounts." The collected funds are deposited in or transmitted to a bank account for the Consortium.

In addition to the requirement to design, arrange for construction of and operate the CSC, the winning bidder is required to perform toll plaza infrastructure and toll lane traffic flow modifications in order to implement the E-Z Pass system and to integrate the ETC data into existing toll audit systems. This will require furnishing and installing the ETC equipment and computers, toll plaza and advance signing, plaza/ramp striping plans, operational plans for plaza and ramp operation and disaster/equipment failure contingency plans, and providing a communications system. Finally, the bank may also propose as part of its bid the technology to issue and use Smart Cards as an optional identification device for toll road patrons that would operate as a substitute for the transponder tags and trigger a debit of the patron's prepaid balance in the "E-Z Pass account."

Should it be the winning bidder, the bank proposes to assign the contract to, if permitted by the Consortium, or have the contract performed under subcontract by, a wholly-owned operating subsidiary of the bank. Required design, construction and equipment installation would be performed by recognized and qualified subcontractors who would indemnify the bank and the subsidiary to the maximum extent for any claims attributable to the work of each of the subcontractors. In addition, the bank and the subsidiary will maintain general liability insurance as appropriate under the circumstances. The primary value to the bank in bidding on the contract is the operation of the CSC for the initial seven-year period which would be conducted by the bank and/or the subsidiary and the possibility of issuing and utilizing Smart Card technology.

II. LEGAL ANALYSIS

Permissibility

The National Bank Act, in relevant part, provides that national banks shall have the power:

[t]o exercise ... all such incidental powers as shall be necessary to carry on the business of banking;

by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes ...

12 U.S.C. 24(Seventh).

The Supreme Court has held that the powers clause of 12 U.S.C. 24(Seventh) is a broad grant of power to engage in the business of banking, including but not limited to the enumerated powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 115 S.Ct. 810 (1995) ("VALIC"). Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank v. State Bank*, 77 U.S. 604, 648 (1871)(certification of checks has grown out of the business needs of the country and involves no greater risk than a bank giving a certificate of deposit); *M&M Leasing Corp. v. Seattle First Nat. Bank*, 563 F.2d 1377, 1382-83 (9th Cir. 1977), *cert. denied*, 436 U.S. 987 (1978) (personal property lease financing is "functionally interchangeable" with the express power to loan money on personal property); *American Insurance Association v. Clarke*, 865 F.2d 278, 282 (D.C. Cir. 1988) (standby credits to insure municipal bonds is "functionally equivalent" to the issuance of a standby letter of credit). Further, as established by the Supreme Court in VALIC, national banks are authorized to engage in an activity if it is incidental to the performance of the five enumerated powers in section 24(Seventh) or if it is incidental to the performance of an activity that is part of the business of banking.

It is well-established that a national bank or its operating subsidiary <NOTE:Such activities that are part of or incidental to the business of banking may also be carried out by means of an operating subsidiary. 12 C.F.R. 5.34(c).> may provide data processing to perform services expressly or incidentally authorized to national banks. *See* OCC Interpretive Letter No. 677 (June 28, 1995) *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83.625. Moreover, the recent revision and renumbering of the OCC Interpretive Ruling stating this authority, 12 C.F.R. 7.3500 (1995), recognizes the rapid advancement of technology and authorizes a national bank to "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide or deliver." *See* the new regulation at 12 C.F.R. 7.1019 (1996).

The collection and processing activities that the bank proposes to perform for the Consortium are clearly part of the business of banking. The Supreme Court has established that 12 U.S.C. 24(Seventh) permits a national bank to "do those acts and occupy those relations which are usual or necessary in making collections of commercial paper and other evidences of debt" for its customers. *Miller v. King*, 223 U.S. 505, 510 (1912) (finding that a national bank may collect a judgment for its customer, and may also sue the bank's attorney in order to recover misused proceeds of the judgment). The activities associated with the operation of the CSC and the activities conducted at the walk-in facilities (including toll road patron tag issuance and "E-Z Pass account" initiation, processing payments and account management on behalf of the Consortium, and the possible issuance of the alternate identification and debit system by means of a Smart Card) essentially are financial management services for a customer (the Consortium) involving collection and remittance of funds. In effect, the bank/subsidiary in operating the CSC is acting as agent for the Consortium in collecting prepaid tolls from the toll road patrons who obtain the tags and set up "E-Z Pass accounts".

Moreover, the described activities are similar to those upheld in Corbett v. Devon, 12 Ill. App.3d 559, 299 N.E.2d 521 (App. Ct. 1st Cir. 1973), where the court found that national banks' participation in Illinois' program for motor vehicle license validation and renewal and the distribution of license plates, remitting fees to the state, was not ultra vires. The court stated that banks "are assisting in the performance of a public service, a large part of which is intimately connected with the ordinary and traditional banking function of collecting and remitting funds for other parties." Corbett, 299 N.E.2d at 529.

Similarly, the bank's or subsidiary's operation of the CSC and the use of the bank's branches as walk-in facilities to conduct the ETC system activities are part of its banking business and, therefore, legally permissible. Under any of the three general standards for determining the scope of the business of banking, collection and remittance activities are permitted to be performed, provided and delivered through electronic means and facilities by the new regulation. First, these activities are clearly functionally equivalent to or a logical outgrowth of recognized banking functions, as acknowledged by the judicial precedent. *See* Miller v. King and Corbett v. Devon *supra*. Second, the bank's performance of these activities will benefit the bank and its customers, both the Consortium and the toll road patrons who can use the bank's many branches to enroll in and use the E-Z Pass system. The bank will benefit from a new source of revenue for operating the CSC and may develop new customer relationships among enrolled E-Z Pass users for its own banking products and services. Finally, the risks to the bank in operating the CSC are the same risks associated with permissible collection and remittance operations the bank performs for other customers, *e.g.*, lockbox operations in which the bank collects funds for crediting to the customers' accounts. Accordingly, these activities are within the scope of the business of banking, may be performed by electronic means and facilities, and, thus, are legally permissible.

Incidental to these permissible banking activities is the ability to arrange for, by means of subcontracting, the one-time design, construction, and installation of facilities and equipment necessary to conduct the activities. As part of the bid package required by the Consortium, and in order to obtain the contract to operate the ETC system at least for seven years, the bank is required to arrange for the one-time design, construction and installation of the facilities and equipment necessary to render the ETC system operational. Consequently, the ability of the bank to arrange for others to perform the nonbanking activities is integral to the bid process to obtain the contract for operation of the banking-related activities. At no time will the bank perform these engineering and construction activities; instead, the bank will arrange for the performance of these activities by qualified subcontractors pursuant to agreements by which the bank and the subsidiary are indemnified to the extent permitted by law. Accordingly, these latter nonbanking activities, undertaken only as part of the bidding process, would be authorized as incidental to the bank's operation of the CSC, should the bank be the winning bidder.

Finally, under 12 U.S.C. 24(Third), a national bank or its operating subsidiary may enter into contracts. Accordingly, the bank can execute a contract to provide the specified banking services to the Consortium and to the toll road patrons using the ETC system by operating the CSC and performing certain activities at the branches ("walk-in facilities"). It can also execute contracts with subcontractors to perform the required design, construction, and installation of facilities and equipment to facilitate the accomplishment of the operational banking activities.

Conclusion

For the foregoing reasons, we conclude that the bank's proposal as described above would be legally

permissible for a national bank and its operating subsidiary. This analysis is based on the facts presented and different circumstances may affect the legal analysis. In addition, this position reflects the application of current law and may be subject to revisions as future developments warrant. Finally, should the bank be the winning bidder, the bank is expected to ensure that these activities would be conducted in a safe and sound manner, adhering to sound prudential banking principles, including appropriate risk management.

If you have any further questions, please do not hesitate to contact either Senior Counsel Madonna Starr or me.

Sincerely,

/s/

Jonathan H. Rushdoony
District Counsel