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Comptroller of the Currency  
Administrator of National Banks

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Central District Office  
One Financial Place, Suite 2700  
440 South LaSalle Street  
Chicago, Illinois 60605

January 18, 2001

**Interpretive Letter #938**  
**July 2002**  
**12 USC 84(d)(2)(b)**

Dear [                    ];

This is in response to your letter of December 11, 2000. You have requested the 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:

[ <i>A</i> ]	29.5%
[ <i>B</i> ]	29.5%
[ <i>C</i> ]	29.5%
[ <i>D</i> ]	8%
[ <i>E</i> ]	2.5%
[ <i>Inc.</i> ]	1%

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% 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:

[ <i>A</i> ]	24.83%
[ <i>B</i> ]	24.83%
[ <i>C</i> ]	24.83%
[ <i>D</i> ]	22%
[ <i>E</i> ]	2.5%
[ <i>Inc.</i> ]	1.01%

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):

EAST	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

WEST	2000	2001	2002	TOTAL
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WEST	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% of the bank's capital and surplus, plus an additional 10% of capital and surplus if the amount over the 15% general limit is fully secured by readily marketable securities.<sup>1</sup> A "borrower" includes a person who is named a borrower or debtor in a loan or extension of credit.<sup>2</sup> Also, loans 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.<sup>3</sup>

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.<sup>4</sup>

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;

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<sup>1</sup> See 12 U.S.C. § 84(a); 12 C.F.R. § 32.2(a).

<sup>2</sup> 12 C.F.R. § 32.2(a).

<sup>3</sup> See 12 C.F.R. § 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 C.F.R. § 32.5. See 12 C.F.R. § 32.2(a).

<sup>4</sup> 12 C.F.R. § 32.5(b)

- (3) the borrowers use the loan proceeds to acquire more than 50% of a business enterprise; or
- (4) the OCC determines that a common enterprise exists based on the facts and circumstances of particular transactions.<sup>5</sup>

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.<sup>6</sup>

**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 C.F.R. § 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 C.F.R. §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

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<sup>5</sup> See 12 C.F.R. § 32.5(c).

<sup>6</sup>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 C.F.R. § 32.5(d). Loans to a corporate group may not exceed 50% of a national bank's capital and surplus. 12 C.F.R. § 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% of the voting interests of the corporation or company. *Id.* This limit is independent of the general 15% limit on loans to one borrower set forth at 12 U.S.C. § 84 and 12 C.F.R. § 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% limit.

- (2) there is substantial financial interdependence between or among the borrowers.<sup>7</sup>

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% 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.<sup>8</sup>

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% or more of one person's annual gross receipts or gross expenditures are derived from transactions with the other person. 12 C.F.R. § 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.<sup>9</sup> Both West and East have a calendar year fiscal period.

Accordingly, if 50% 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% 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% and 72%, respectively, of West's and East's gross annual expenditures for the fiscal year 2001.<sup>10</sup> Thus, for the year

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<sup>7</sup> See 12 C.F.R. § 32.5(c)(2).

<sup>8</sup> See 12 C.F.R. § 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 C.F.R. § 32.2(k).

<sup>9</sup> See OCC Interpretive Letter from Jonathan Rushdooney, Attorney (December 24, 1986) (unpublished).

<sup>10</sup> West's projected site development costs for 2001 of \$8,700M divided by its total projected expenditures for 2001 of \$10,226M equals 85%; East's projected site development costs for 2001 of \$1,075M divided by its total projected expenditures for 2001 of \$1,494M equals 72%.

2001, there will be substantial financial interdependence between West and [ *Inc.2* ] and between East and [ *Inc.2* ].<sup>11</sup>

Consequently, for the year 2001 loans to West will be attributed to [ *Inc.2* ] because (1) the two entities are related through common control, and (2) substantial financial interdependence exists between the two entities for the year 2001. Likewise, for the year 2001 loans to East will be attributed to [ *Inc.2* ] because (1) the two entities are related through common control, and (2) substantial financial interdependence exists between the two entities for the year 2001. Thus, the loans to West and East will be attributed to [ *Inc.2* ] during 2001, and therefore are combined for the purpose of the lending limit under 12 C.F.R. § 32.5(c)(2).

***D. Common Enterprise Test # 3 - Borrowing to Acquire Control***

This test is not applicable to the West and East loans.

***E. Common Enterprise Test # 4 - Facts and Circumstances***

OCC rulings and interpretations reveal that a very strong evidentiary record based upon a number of factors must exist before a common enterprise will be found to exist solely on the basis of the facts and circumstances test.<sup>12</sup> In administrative opinions and interpretive letters, the OCC has considered the following facts and circumstances to be relevant to a common enterprise determination: engaging in supporting lines of business, interchange of goods and services, common ownership of assets, common management, use of common facilities, commingling of assets and liabilities, closely related business activities, similarity in structure, financing and holding, use of same business address, centralized cash management program, likelihood that a financially troubled member of the group would receive financial aid from

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<sup>11</sup> Note that the critical issue here is the percentage of West's and East's gross expenditure paid to [ *Inc.2* ], not whether 100% of the site development cost will be paid to [ *Inc.2* ].

<sup>12</sup>Interpretive Letter No. 563, reprinted in [1991-1992 Transfer Binder] Fed. Banking L. Rep. ¶83,314, at 71,439 (September 6, 1991).

other members of the group, family relationships among the borrowers, and pledging of assets to support another person's loans.<sup>13</sup>

Based on the information provided in your letter, I am unable to determine with any certainty whether the loans to West and East should be combined for lending limit purposes under the facts and circumstances test.

### III. Conclusion

Based on the information provided and the assumption that all of the site development costs will be paid to [ *Inc.2* ], the loans to West and East will be attributed to [ *Inc.2* ] for the year 2001 under the common enterprise test at 12 C.F.R. § 32.5(c)(2) and thus combined for purposes of the legal lending limit. If all of the site development costs will not be paid to [ *Inc.2* ], but where payments by West and East to [ *Inc.2* ] during a fiscal period will still represent 50% or more of each company's gross expenditures for that period, the same attribution and combination results.

I trust this is responsive to your request. If you have any further questions, please contact me at (312) 360-8805.

Very truly yours,

**-signed-**

Christopher G. Sablich  
Senior Attorney

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<sup>13</sup>*Id.*; see also Kenneth C. Rojc, *National Bank Lending Limits - A New Framework*, 40 Bus. Law. 903, 923-24 (1985)(citing various OCC interpretive letters).