Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #321
August 1999

July 28, 1999

Daniel P. Cooney
Senior Vice President and Associate General Counsel
The First National Bank of Chicago
Bank One Corporation
One First National Plaza, Mail Suite 0292
Chicago, IL 60670

Re: Application of Bank One, N.A., Columbus, OH to Acquire a Noncontrolling Interest in a Limited Liability Company through an Existing Operating Subsidiary
Application Control No. 1999-ML-08-008

Dear Mr. Cooney:

This letter responds to the application filed by Bank One, N.A., Columbus, Ohio ("the Bank") for the Bank's operating subsidiary to acquire and hold a 49 percent interest in CD1Financial.com, LLC. You have also requested confirmation that the Bank may acquire and retain, but not exercise, warrants to purchase shares of the Company in connection with the proposed investment. For the reasons set forth below, the application is approved subject to the conditions set forth herein.

Background

The Bank seeks approval pursuant to 12 C.F.R. § 5.34 to invest, through an existing operating subsidiary, Banc One Vehicle Finance Corporation, in a new joint venture to provide automobile financing through the Internet. The joint venture entity, CD1 Financial.com, LLC ("the LLC"), a Delaware limited liability company, will initially be owned 49% by the Bank's operating subsidiary and 51% by CarsDirect.com ("the Company"), a Delaware corporation that is engaged in the sale of cars over the Internet.[1]

[1] Under the Operating Agreement for the joint venture, additional members may be added only if the Company and the Bank both approve; provided, however, that over time up to 20% of the membership interests in the joint venture may be issued to employees of the joint venture as incentive compensation. Assuming all of this 20% were issued to employees, the respective ownership positions of the Bank and the Company would be approximately 39% and 41%.

The Bank and the Company plan to enter into a joint venture to provide automobile financing to customers purchasing cars from the Company over the Internet. The Bank and the Company envision that this joint venture will enable customers to obtain "one-stop shopping" for both a car and its financing. In the early stages of the joint venture credit application information will be obtained over the phone by LLC representatives and then forwarded to the Bank. Thus, the credit approval and funding process will generally function in a manner similar to that with any application for financing placed through a car dealer. As the joint venture business develops the parties hope to develop a method for the electronic capture of the credit application data.

Analysis

The Bank's proposal to hold up to a 49% interest in the LLC raises the issue of the authority of a national bank to make a non-controlling minority investment in a limited liability company that will facilitate the provision of financing to purchasers of cars over the Internet. In a variety of circumstances the OCC has permitted national banks to own, either directly or indirectly through an operating subsidiary, a non-controlling interest in an enterprise. The enterprise might be a limited partnership, a corporation, or a limited liability company.[2] In various interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in a limited liability company, provided four criteria or standards are met.[3] These standards, which have been distilled from our previous decisions in the area of permissible non-controlling investments for national banks and their subsidiaries are:

(1) The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;

(2) The bank must be able to prevent the entity or enterprise from engaging in activities that do not meet the foregoing standard or be able to withdraw its investment;

(3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and

(4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Each of these factors is discussed below and applied to your proposal.

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[2] *See* 12 C.F.R. § 5.34; *see also* 12 C.F.R. § 5.36(b) (National banks are permitted to made various types of equity investments pursuant to 12 U.S.C. § 24(Seventh) and other statutes.).

[3] *See, e.g.*, Interpretive Letter No. 778, *reprinted in* [1997 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-205 (Mar. 20, 1997); Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-007 (Nov. 1, 1995).

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.

Our precedents on non-controlling stock ownership have recognized that the enterprise in which the bank takes an equity interest must confine its activities to those that are part of, or incidental to, the business of banking.[4] It is clear that the activities to be performed through the LCC, automobile lending and lease financing, are permissible activities for national banks.[5] Further, a Bank may offer by electronic means any product or service it is permitted to offer through traditional means.[6]

The Bank, or one of its affiliates or correspondents, will provide the automobile loans and leases directly to customers of the Company. The Bank will perform the credit analysis and make the decision whether to extend credit to a particular customer. Because the Bank and the Company believe that Internet car purchasers will be highly price sensitive, the Bank has agreed to offer financing at the low end of its target pricing range. To offset the lower interest rate the Company will issue a stock purchase warrant to the Bank. The Bank has agreed that it will not exercise the warrant. Instead, if in the future there is value to be realized, the Bank will achieve this by selling the warrant to a third party.[7] In this way the Bank will have the opportunity to share in the success of the venture, as reflected in the Company's success, in lieu of the higher interest rate the Bank could have received.

The OCC has long permitted national banks to accept warrants as partial compensation when structuring loans. Interpretive Letter No. 517 formalized this position in 1990, and it is currently codified in Interpretive Ruling 7.1006, 12 C.F.R. § 7.1006, permitting national banks to take a share in the profits of a business in addition to, or in lieu of, interest on a loan.[8] In this case, although the proposed holding of the warrant is tied to a lending program, it will be issued by a co-venturer rather than a borrower. The borrowers will be individuals financing

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[4] *See, e.g.*, Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-026 (Feb. 23, 1996) (national bank may take a minority equity interest in a mortgage banking company); Interpretive Letter No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-009 (Dec. 13, 1995) (national bank permitted to make non-controlling investment in a limited liability company that purchases secured home improvement loans and resells them in the secondary market); Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 85,604 n8 (Dec. 29, 1986) (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services).

[5] *See* 12 U.S.C. §§ 24(Seventh) and 84 (loans and lending limits); 12 C.F.R. §§ 5.34(e)(2)(ii)(L) and (M) (making loans and leases of personal property eligible for notice); M & M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377 (9th Cir. 1977) (auto lease financing); 12 C.F.R. Part 23 (lease financing generally).

[6] *See* 12 C.F.R. § 7.1019.

[7] Currently the Company is privately held. The value of the warrant will increase as the value of the Company's stock increases. The Bank and the Company anticipate that the success of the joint venture will contribute to the success of the Company, which will in turn be reflected in its stock price. If the Bank sells the warrant to a third party, that party will not be able to exercise it unless and until the Company offers its stock to the public or its ownership changes hands.

[8] OCC Interpretive Letter No. 517, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,228 (Aug. 16, 1990); 12 C.F.R. § 7.1006 (1998).

their automobile purchases and leases. The function of the warrant in the transaction will be comparable, however, to that described in Interpretive Ruling 7.1006. The Bank and the Company believe that Internet car buyers will be very price sensitive and, thus, the Bank has agreed to offer the loans at the low end of its target rate structure. Both parties consider this pricing necessary to the success of the loan program. Thus, here, as in the Interpretive Ruling, the warrant serves to supplement the lower interest yield on loans made by the Bank. Therefore, it is permissible for the Bank to acquire and retain, but not exercise, the warrant to purchase stock of the Company.

Therefore, the first standard is satisfied.

2. The bank must be able to prevent the entity or enterprise from engaging in activities that do not meet the foregoing standard or be able to withdraw its investment.

This is an obvious corollary to the first standard. The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank first acquires its ownership, but for so long as the bank has an ownership interest.

Your letter states that the organization, membership, and operating documents and agreements prevent the LLC from engaging in activities not authorized for national banks. Documents submitted to us confirm your representations that this standard is satisfied.

Specifically, section 2.3(b) of the Operating Agreement provides that the LLC "…may engage only in activities which are legally permissible for national banks." That section further provides that the business of the LLC may be expanded or revised only with the unanimous approval of the managing members. Moreover, any member that is a national bank or a national bank subsidiary shall have the authority to veto or withdraw from the joint venture in the event that the LLC engages in activities that are otherwise not permissible for national banks. Section 6.2(xvii) of the Operating Agreement provides that the joint venture cannot conduct or enter into any business requiring receipt by the Bank or LLC of any banking regulatory agency approval without the consent of both the Company and the Bank. Section 10.5 of the Operating Agreement provides that the Operating Agreement itself can only be amended, other than for technical and ministerial changes, with the unanimous written consent of the managing members. Therefore, the second standard is satisfied.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an

interest, it is important that the national bank's investment not expose it to unlimited liability. Normally, this is not a concern when a national bank invests in a corporation, for shareholders are not liable for the debts of the corporation, provided proper corporate separateness is maintained.[9] In the present case, the Bank and its operating subsidiary are separate corporations distinct from each other and from the LLC.

As a legal matter, the Bank's risk of loss will be limited by Delaware law. No member or manager of a Delaware limited liability company is personally liable for any debts, obligations, or liability of the limited liability company solely by being a member or acting as a manager of the limited liability company.[10] Therefore, the Bank's risk of loss is limited to the amount of its capital investment in the LLC.[11] In addition, under Ohio corporate law, a shareholder as a general rule is not liable or responsible for the debts of a corporation solely because he is a shareholder of that corporation.[12] The Bank is further insulated from liability by the "corporate veil" under corporate law since its interest in the LLC is held through the Bank's operating subsidiary, which is a separately capitalized Ohio corporation. Thus, the Bank's loss exposure for any liabilities of the LLC will be limited.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's 20-50% investment in a corporation or limited liability company is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books.[13] As proposed, the Bank will have between a 39% and 49% ownership share in the LLC. The Bank has represented that it will account for this investment using the equity method of accounting.

As noted above, Ohio law limits the Bank's losses to its capital investment. In addition, the Operating Agreement contains provisions that confirm that no investor in the LLC will have liability for the debts and obligations of the LLC. Therefore, for both legal and accounting purposes, the Bank's potential loss exposure to the LLC should be limited to the amount of its investment. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

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[9] *See* 1 William M. Fletcher, Fletcher Cyc. Corp. § 25 (Perm. Ed. 1999).

[10] *See* Del. Code Ann. tit. 6, § 18-303 (1998).

[11] The Bank's initial capital contribution will be $2 million. The Bank is further obligated to contribute up to an additional $8 million over the life of the joint venture if the Board of Directors of the LLC determines that such capital is required to support the LLC's activities. However, no more than $2 million additional capital may be required in any year and no additional capital may be required until after the first year.

[12] *See* Ohio Rev. Code Ann. § 1701 *et seq.* (1998).

[13] *See generally* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock).

4. The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

A national bank's investment in an enterprise or entity that is not an operating subsidiary of the bank must also satisfy the requirement that the investment have a beneficial connection to that bank's banking business, *i.e.*, it must be convenient or useful to the investing bank's business activities and not constitute a mere passive investment unrelated to the bank's banking business. Twelve U.S.C. § 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful."[14] Therefore, a consistent concept running through our precedent concerning stock ownership is that it must be convenient or useful to the bank in conducting that bank's banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[15]

The Bank's investment in the LLC will not be a passive investment. The Bank anticipates the enhancement of its automobile lending and leasing business and the development of new business opportunities as a result of its ownership in the LLC. The Bank hopes to provide vehicle financing to customers purchasing automobiles from the Company over the Internet. The Bank's joint venture with the Company, through the LLC, will allow the Bank to service customers it might not otherwise have reached. Thus, the fourth standard is satisfied.

Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, the OCC finds that the Bank may acquire and hold, through an existing operating subsidiary, a non-controlling interest in the LLC in the manner described herein. Our conclusion is conditioned upon compliance with the commitments made in your letter of inquiry and with the conditions listed below:

(1) The LLC will engage only in activities that are part of, or incidental to, the business of banking;

(2) The Bank will have veto power over any activities and major decisions of the LLC and that are inconsistent with condition number one or the Bank will withdraw its investment from the LLC if it proposes to engage in any activity that is inconsistent with condition number one;

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[14] Arnold Tours, Inc. v. Camp, 472 F.2d 427, 432 (1st Cir. 1972).

[15] *See, e.g.*, Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 83,255 (Feb. 13, 1991) (national bank authorized to acquire nominal stockholding for membership in corporation of primary dealers in government securities); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 85,651 (May 9, 1988) (national bank permitted to buy Farmer Mac stock in nominal amounts); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 85,645 (Mar. 14, 1988) (national bank permitted to invest in the Government Securities Clearing Corporation).

(3) The Bank will account for its investment in the LLC as an unconsolidated entity under the equity or cost method of accounting; and

(4) The LLC will be subject to OCC supervision, regulation, and examination.

Please be advised that the conditions of this approval are deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818. This approval is granted based on a thorough review of all information available, including the representations and commitments made in the application and by the Bank's representatives.

If you have questions, please contact William Glidden, Assistant Director, Bank Activities and Structure Division at 202-874-5300.

Sincerely,

/s/

Julie L. Williams
Chief Counsel