Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 10, 1998

Corporate Decision #98-35
July 1998

Mark E. Plotkin, Esq.
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Re: Operating Subsidiary Notifications of Bank of America National Trust & Savings Association, San Francisco, California, and BankBoston, National Association, Boston, Massachusetts. Application Control Numbers: 98-ML-08-0007 & 0008

Dear Mr. Plotkin:

This is in response to your application dated May 19, 1998 on behalf Bank of America National Trust & Savings Association, San Francisco, California ("BofA"), and BankBoston, National Association, Boston, Massachusetts ("BankBoston") (collectively, "Banks"), to acquire, through operating subsidiaries, indirect non-controlling minority interests in a de novo limited liability company, Bay 2 Bay Leasing LLC ("LLC"). In addition, BankBoston also is applying to establish an operating subsidiary which will acquire and hold its non-controlling minority interest in the LLC. The LLC will engage in certain leasing activities. For the reasons set forth below, we approve the establishment of the LLC and the operating subsidiary, subject to certain conditions.

I. Background

Banks propose to establish and acquire indirect non-controlling minority interests in a de novo limited liability company LLC. BofA proposes to hold its interest in LLC through its wholly-owned subsidiary, BA Leasing & Capital Corporation ("BA Leasing"). BankBoston proposes to establish a wholly-owned operating subsidiary, Electra Leasing LLC ("Electra") (BA Leasing and Electra collectively, "Subsidiaries") which will hold a non-controlling interest for BankBoston in the newly-formed LLC.

Banks will organize the LLC and will transfer into LLC some of their leveraged and single investor lease assets from their, or their affiliates', respective lease portfolios to the LLC in exchange for an interest in the shared revenues from the contributed leases. The LLC will manage this portfolio of leases and Banks will be compensated in proportion to the size and type of assets they contribute to the LLC. As explained in further detail below, two of the

leases to be transferred into the LLC's portfolio are for personal property that contain incidental real property interests.

The LLC will be established under Delaware law. The LLC will be governed by an operating agreement between Banks, and Banks will be designated as the two voting members of the LLC. Among other things, the terms of the operating agreement provide that for as long as Banks or their affiliates are members of LLC, the LLC will not engage in any activities that are not permitted for national banks or entities in which national banks may invest. Also, the LLC will be managed by BA Leasing as the Management Member. Under the terms of the management agreement, certain fundamental actions (including any change in the nature of the business of the LLC or the sale of assets) may not be undertaken without the consent of both voting members, resulting in neither member being able to control the LLC independently.

II. Discussion

A. National Bank Express and Incidental Powers (12 U.S.C. § 24(Seventh))

A national bank may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(d)(1). To qualify as an operating subsidiary, the parent bank must own at least 50 percent of the voting stock of the corporation. 12 C.F.R. § 5.34(d)(2). BankBoston will indirectly hold a 100% interest in Electra. Accordingly, BankBoston may establish Electra as an operating subsidiary pursuant to 12 C.F.R. § 5.34.

The remaining issue presented by your notice concerns the authority of a national bank to hold--indirectly through an operating subsidiary--a non-controlling interest in an enterprise such as the LLC. A number of recent OCC Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in a limited liability company.[1] These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[2] They 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 from its investment;

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[1] *E.g.*, Conditional Approval Letter No. 269, (January 13, 1998); Interpretive Letter No. 694 (December 13, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-009; Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-007.

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

(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.

In addition, the OCC has also permitted national banks to make a non-controlling investment in an enterprise other than an LLC, provided the investment satisfies these four standards. Each of these four factors is discussed below and applied to your proposal.[3]

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] Whether conducted directly or through operating subsidiaries, personal property leasing activities are part of, or incidental to, the business of banking under 12 U.S.C. § 24(Seventh) and(Tenth). *See* 12 C.F.R. § 5.34(e)(2)(ii)(M) and 12 C.F.R. Part 23. *See also M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (1977), *cert. denied* 436 U.S. 956 (1978). As previously stated, two of the leases to be transferred into the LLC's portfolio are for personal property that contain incidental real property interests. Those leases consist of a lease held by an affiliate of BofA for a gasoline additive manufacturing facility ("BA Facility Lease") and a lease held by a subsidiary of BankBoston for an automobile assembly facility ("BKB Facility Lease") (collectively, "Leases"). In both cases the personal property components of the Leases clearly conform to the requirements of 12 C.F.R. Part 23 that the lease of personal property be a net, full-payout lease; that the lease be a noncancelable obligation of the lessee; and that the estimated residual

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[3] *See e.g.*, Conditional Approval Letter No. 200 (April 12, 1996); Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996); Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-012; Interpretive Letter No. 705 (October 25, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81-020.

[4] *See, e.g.*, Interpretive Letter No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-009 (December 13, 1995) (national bank permitted to take non-controlling, minority interest in a limited liability company that purchases secured home improvement loans and resells them in the secondary market); Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23, 1996) (national bank to take minority equity interest in mortgage banking company); Interpretive Letter No 380 (December 29, 1986), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85-604 n.8 (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services); Letter of Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is a "fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

value be a maximum of 25% of the original cost of the property. An additional component of the Leases, however, are site leases for the properties on which the facilities stand.

Part 23, as revised, recognizes that a national bank may engage in activities that are "incidental" to permissible personal property leasing. In the preamble to the final rule, the OCC stated that it retained the authority to approve those activities on a case-by-case basis.[5] Banks represent that the LLC's obligations under the site leases will not involve any real estate construction or the acquisition or leasing of real property for the purpose of speculation. Rather, the site leases being transferred into LLC exist in order to better protect the value and utility of the financed equipment. The site leases will allow the LLC to sustain the value of the personal property collateral in the event of default by ensuring the use of the facilities as going concerns rather than requiring the piecemeal liquidation of the facilities if such site leases did not exist.

Real property leasing as an "incidental" activity was contemplated in the promulgation of the Part 23 leasing rule. In the preamble to the final rule, the OCC discussed a typical facility leasing transaction[6] and concluded that

> … under some circumstances real estate leasing may be an incidental component of a personal property leasing transaction. Therefore, consistent with its decision to retain a case-by-case approach to activities incidental to leasing generally, the OCC will determine the permissibility of personal property lease financing transactions that have a real estate leasing component based upon the facts of a given lease financing transaction . . . . This will enable the OCC to review any safety or soundness or other supervisory concerns that particular transactions may present.

61 Fed Reg. 66554, 66556 (December 18, 1996).

The primary concern in permitting a bank to become a party to a real property lease is the restrictions imposed by 12 U.S.C. § 29 which states:

> A national banking association may purchase, hold and convey real estate for the following purposes, and for no others:
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> **First** Such as shall be necessary for its accommodation in the transaction of its business.

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[5] Id., at 66556.

[6] The OCC also requested comments on the use of real property as incidental to personal property leasing, such as facility leasing, in its Notice of Proposed Rulemaking for Part 23. 60 Fed Reg. 46246, 46248 (September 6, 1995).

> **Second** Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.
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> **Third** Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.
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> **Fourth** Such as it shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due to it.
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> But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due to it, for a longer period than five years except as otherwise provided in this section.

12 U.S.C. § 29.

A threshold question raised by Section 29 is whether real property leasing was contemplated as being within the purview of the statute. For the purposes of this analysis only, we assume that a leasehold interest in real estate is subject to the restrictions of Section 29.[7]

The OCC has previously approved facility leasing transactions.[8] In addition, the OCC clarified its position when it revised Part 23. As discussed above, Part 23 recognizes as permissible the incidental use of real property to secure a bank's interest in personal property that it is leasing, depending on the facts of a given case. This position is predicated on the real property interests being, in fact, incidental to the primary transaction - the personal property lease. The measure of what constitutes "incidental" will vary in each case depending on the facts.

In the proposed transaction, several factors indicate that the site leases are incidental to the facility leases. First, the LLC need not advance any money for the site leases because the rent amount to be paid by the lessees to the LLC exactly equals the rent that the LLC must pay under the site leases. Because of these matched obligations, there is no cost to the

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[7] This proposed leasehold interest arguably is permissible under the actual wording of the statute. Section 29 says that no bank may hold "possession" or "title and possession" of real estate. In this case, neither the Banks nor the LLC would have neither title to the property, nor actual possession of it during the term of the Leases. At the point that the LLC might take possession of the property, i.e. upon termination of one of the Leases, the LLC would be required to divest itself of its interest in the site lease within 10 years.

[8] *See*, Interpretive Letter No. 770 (February 10, 1997), *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. ¶ 81-134.

LLC for the site leases as compared to the substantial cost to it for the facilities leases.[9] Second, the LLC is under no legal obligation to pay rent under the site leases unless the lessee companies pay rent under the site leases. Further, the LLC will only have a leasehold interest in the real property - not legal title. Its interest in the real property is directly related to the amount of time it will take the LLC to recoup its investment in the facilities, at which point its leasehold interest will expire.[10] Finally, the Banks have represented that the only purpose in entering into the site leases is to ensure the value of the equipment being leased under the Leases.

The site leases are not inconsistent with any of the purposes underlying the restrictions of Section 29.[11] The Banks' funds are not being removed from the channels of commerce because the LLC will not be obligated to pay rent unless the companies leasing the facilities from the LLC pay rent to the LLC. There is no speculation in the value of real estate because the amounts owing under the site leases to the lessee companies are identical. Finally, no large mass of real estate will be accumulated or held by the LLC as the LLC is limited to a leasehold interest in the sites in question.

In addition, the proposed transaction proposes no immediate safety and soundness concerns. The payment of rent on the subsidiary site leases is guaranteed by the lessees. Further, as mentioned earlier, the LLC is under no obligation to pay on the site leases unless the lessees pay on the subsidiary site leases. Finally, both the facilities leases and the site leases have a cross-default provision which would allow the LLC to operate the facilities if there were a default under either agreement. This provision would insulate the LLC from the possibility of having to disassemble the facilities and liquidate them in the event of default.

Therefore, for the reasons already stated, and based on the representations made to us, as summarized herein, we conclude that managing personal property leases plus engaging in

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[9] The BKB Facility Lease does contain a provision assessing a rent of $50 per year. In light of this nominal obligation, there will be no meaningful cost to LLC for the site lease for this facility.

[10] Although the site leases for each of the properties run approximately 7 and 15 years longer than the Leases, the Banks have indicated that the reason for this provision is to ensure the marketability of the facilities at the close of the lease terms. If the remaining useful life of the facilities cannot be utilized because the real property on which it sits no longer is transferable, then the LLC will be unable to sell or release the facilities after the facility Lease with the companies end.

[11] For example, the Supreme Court in Union National Bank v. Matthews, stated that

> [t]he object of [Section 29] was obviously threefold. It was to keep the capital of the banks flowing in the daily channels of commerce; to deter them from embarking in hazardous real estate speculations; and to prevent the accumulation of large masses of such property in their hands, to be held, as it were, in mortmain.

98 U.S. 621, 626 (1878).

facility leveraged lease transactions are permissible under 12 U.S.C. 24(Seventh). However, the Banks must at all times comply with the requirements set out in 12 CFR Part 23, including the requirement to divest of any off-lease interests within the appropriate divestiture period.

Thus, with respect to the LLC, this standard is satisfied.

2. The bank must be able to prevent the 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 as long as the bank has an ownership interest.

Several provisions in the LLC Agreement ("the Agreement") are designed to satisfy the requirement that the LLC's activities remain part of, or incidental to, the business of banking. The Agreement provides that, for as long as affiliates of BankBoston Corporation or BankAmerica Corporation are members of the LLC, the LLC will not engage in, and the LLC shall withdraw as promptly as practicable from, any activities that are not permitted for a national banking association. Thus, with respect to the LLC, this standard is met.

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 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 a national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Delaware limited liability company do not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Del. Code Ann. Tit. 6 § 18-303 (1994). Thus, the Banks' loss exposure for the liability of the LLC is limited by statute and by the Agreement establishing the LLC. Moreover, the Banks are further protected from liability since the interests in the LLC are held by the Subsidiaries.

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 percent ownership share of

investment in a 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. *See generally* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). *See also* Interpretive Letter 692, *supra.*

As proposed, the Subsidiaries each will have a 50 percent ownership interest in the LLC. The Banks believe that the appropriate accounting treatment for the Subsidiaries' investments is the equity method. Thus the Banks' losses from an accounting perspective would be limited to the amount invested in the LLC and the Banks will not have any open-ended liability for the obligations of the LLC. In addition, as noted above, Delaware law limits members' losses to their capital investment. Therefore, with respect to the LLC, the third standard is satisfied.

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 must also satisfy the requirement that the investment have a beneficial connection to the *bank's* business, *i.e.*, be convenient or useful to the investing bank's business activities, and not constitute a mere passive investment unrelated to that 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." *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427,432 (1st Cir. 1972). Section 24(Seventh) does not authorize national banks to engage in speculative, investment banking activities with respect to stock. *See* Interpretive Letter No. 697, *supra*. Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to *that bank's* banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[12]

Establishing and holding a non-controlling interest in the LLC will benefit the Banks in carrying out their business. Banks' investment in the LLC is motivated by a desire to achieve substantial economic and managerial efficiencies that both Banks expect to realize by virtue of the proposed transaction. Specifically, by combining existing lease assets from both Banks and their affiliates under the management of a single experienced entity, both organizations free up needed personnel resources for the pursuit of additional leasing business. Both organizations also will correspondingly benefit from lower marginal costs in managing such

[12] *See e.g.*, Conditional Approval Letter No. 248, (June 27, 1997); Conditional Approval Letter No. 200, *supra*; Interpretive Letter No. 543 (February 13, 1991), *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-225.

lease assets. In addition, the proposed transaction has the further benefit of diversifying both Banks' risk across a larger pool of lease assets. Thus, the investment is "necessary" to the Banks' ability to carry out their banking business efficiently and capably and to compete effectively in the leasing market.

For these reasons, the Banks' investment in the LLC is convenient and useful to the Banks in carrying out their business and are not a mere passive investment. Thus, the fourth standard is satisfied.

D. CONCLUSION

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that BankBoston may establish Electra as an operating subsidiary, and the Banks may each hold, through BA Leasing and Electra, a noncontrolling interest in the LLC. Our conclusion is conditioned upon the following conditions:

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

(2) The Banks through their Subsidiaries will have veto power over any activities and major decisions of the LLC that are inconsistent with condition number one, or withdraw from the LLC in the event it engages in an activity that is inconsistent with condition number one;

(3) The Banks through their Subsidiaries will account for the investments in the LLC under the equity method of accounting; and,

(4) 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 by the Banks' representatives.

If you have any questions, please contact John A. Soboeiro, Senior Attorney, at (202) 874-5300 or Cindy Hausch-Booth, at (202) 874-5060.

Sincerely,

/s/

Raymond Natter
Acting Chief Counsel