Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1074
November 2006

November 21, 2006

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American Bankers Association
1120 Connecticut Avenue NW
Washington, DC 20036

Subject: Applicability of Lending Limit to Wind Tower Lending Programs

Dear Mr. Smith:

We are writing in response to your request for an opinion as to the application of the lending limit, 12 U.S.C. § 84 and 12 C.F.R. part 32, to a circumstance involving loans to wind tower companies that you believe to be representative of issues facing a number of banks. You set forth four questions relating to the potential aggregation of such loans under the combination rules of the lending limit regulation, 12 C.F.R. § 32.5. These questions are addressed below.

Background

As described in your request, limited liability companies (LLCs) are formed to purchase and operate wind towers and sell the power that is generated. Each LLC is formed by an individual farmer or small group of farmers (Farmer) and a common investor (Investor) that provides the majority of the equity financing for the project. The Farmer seeks to supplement and diversify traditional sources of revenue. The Investor is attracted by the benefits of federal tax credits associated with the production of output from a qualified wind generation facility and accelerated depreciation associated with an investment in such facility. The Investor typically holds a significant percentage ownership of the LLC, and also may be the manager of the LLC pursuant to a management contract. Minority ownership interests in the LLC are held by the Farmer and, in some cases, other investors.[1]

In the circumstances you present, a national bank would provide project debt financing to the separate LLCs but would not hold an interest in the LLCs. The bank would extend no credit to the Investor. The Farmer provides the LLC with the right to use farmland for the operation of the tower and the right-of-way necessary for power transmission lines. Each LLC sells its power to a common purchaser, a major utility within a particular region, pursuant to a power purchase

[1] In a common ownership model, after 10 years when the federal tax credit benefit ends, the ownership shares convert so that the formerly minority owners are now the majority owners for the remaining life of the project.

agreement. Wind power generation is the sole business for the LLCs. Income from such activity is the LLCs' sole source of revenue and accounts for most of their annual gross receipts. Debt service payments to the bank account for most of the annual expenditures of each LLC. The LLCs are not financially interdependent. Finally, annual revenue from an LLC is not a significant percentage of the Investor's income.

Applicable Law

The purpose of the lending limit is to protect the safety and soundness of national banks by preventing excessive loans to one person and to promote diversification of loans and equitable access to banking services.[2] 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 collateral.[3] A "borrower" includes a person who is named a borrower in a loan or extension of credit and also a guarantor (or any other person) who is deemed to be a borrower under the direct benefit test or common enterprise test in 12 C.F.R. § 32.5.[4]

Pursuant to section 32.5, loans to one borrower will be attributed to another person when proceeds of a loan or extension of credit are to be used for the direct benefit of the other person,[5] to the extent of the proceeds so used, or when a common enterprise is deemed to exist. A common enterprise is deemed to exist, *inter alia*, (i) when the expected source of repayment for each loan is the same and neither borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid;[6] (ii) when loans are made to borrowers who are related directly or indirectly through common control, including when one borrower is directly or indirectly controlled by another borrower, and substantial financial interdependence exists between or among the borrowers;[7] or (iii) when the OCC determines, based on an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists.[8]

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[2] 12 C.F.R. § 32.1(b).

[3] 12 U.S.C. § 84(a); 12 C.F.R. § 32.3(a).

[4] 12 C.F.R. § 32.2(a).

[5] The proceeds will be deemed to be used for the direct benefit of another when they, or assets purchased with the proceeds, are transferred to the other person, other than in a bona fide arm's length transaction in which the proceeds are used to acquire property, goods, or services. *See* 12 C.F.R. § 32.5(b).

[6] 12 C.F.R. § 32.5(c)(1).

[7] 12 C.F.R. § 32.5(c)(2). Substantial financial interdependence is deemed to exist when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues/expenses, inter-company loans, dividends, capital contributions, and similar receipts or payments.

[8] 12 C.F.R. § 32.5(c)(4).

Analysis

Your first question is whether the LLCs' financial reliance on the same utility company should result in combination of a bank's loans to the separate LLCs under the common source of repayment prong of the common enterprise test. Your second question is whether the availability of one or more alternative power purchasers may avoid combination. These questions can be addressed together.

The common source of repayment prong of the common enterprise test (Source of Repayment Prong) provides that loans to borrowers are combined when the expected source of repayment for each loan is the same for each borrower and no borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid. Here, the expected source of repayment for loans to separate LLCs is the revenue received by each LLC from its sole source of income: the sale of power to the same purchaser. This source of repayment is documented in the power purchase agreements. Thus, absent other facts demonstrated by a national bank, the loans would be combined.[9]

The reasonable availability of an alternate source of repayment for particular types of loans will vary depending upon the business associated with the loan. Because the markets for wind energy may not be as diverse or accessible as other markets, the factors the OCC would consider to support a conclusion that the loans in question would not be combined include evidence of the willingness, ability and capacity of alternative sources of repayment that could fully service the debt. For example, qualifying alternatives could include the existence of a spot market into which the LLC's output could be sold, or the presence of another power company that has a legal obligation or a clear economic or other incentive to purchase the LLC's power output. Whether such alternative sources of income exist will depend on the facts of a given wind tower financing, including the regional transmission infrastructure, grid integration and transmission access, and the regional electricity market. In some parts of the country real-time or spot markets exist into which wind-generated output can be sold.[10] For example, the Midwest Independent Transmission System Operator has developed a real-time energy market.[11] Any institution relying on alternative sources of income to alter the loan combination outcome for

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[9] *See*, *e.g.*, Letter of Ray Natter, Deputy Chief Counsel (Sept. 29, 2004) (unpublished). The issuance of a qualifying government loan guarantee could avoid loan combination. Under 12 C.F.R. § 32.3(c)(4), certain government guarantees can cause a loan to be exempted from the lending limit. If a loan is exempted from the lending limit, it cannot be combined with other loans under the combination rules.

[10] For further details, see the RTO-ISO handbook produced by staff of the Federal Energy Regulatory Commission and available at http://www.ferc.gov/industries/electric/indus-act/rto/handbook.asp (RTO-ISO handbook). RTO and ISO are acronyms that stand for Regional Transmission Organization and Independent System Operator respectively. RTOs aim to promote efficiency in wholesale electricity markets. ISOs are independent, federally regulated entities established to coordinate regional transmission and ensure the safety and reliability of the electric system.

[11] *See* Order of the Federal Energy Regulatory Commission re Midwest Independent Transmission System Operator, Inc., 108 FERC ¶ 61,163 (2004) and the RTO-ISO handbook. Staff of the Midwest Independent Transmission System Operator has informed us that wind generators in the MISO footprint will have a defined "commercial pricing node" and therefore can automatically sell into the market, while wind generators outside of the regional footprint must have a "physical schedule import," including transmission, in order to sell to the market.

wind tower financings must fully document its reasoning for such reliance at a minimum when the wind tower loan is made and whenever it is renewed.

Your third question probes the effect on the common source of repayment analysis if the Investor guarantees the loans to the separate LLCs. The taking of a guarantee does not avoid combination of loans otherwise combinable under the Source of Repayment Prong. If the loans were not otherwise combinable and the bank were to obtain a guarantee from the Investor, the only question raised would be whether the loans should also be attributed to the guarantor.[12] Provided the bank reasonably could expect the borrower LLCs to fully repay their loans and other obligations from the sale of power, the Source of Repayment Prong would not cause the loans to be attributed to a guarantor.

Your fourth question addresses the applicability of the common control and substantial financial interdependence prong of the common enterprise test (Control & Interdependence Prong). Under the Control & Interdependence Prong, loans to separate borrowers are combined when (i) borrowers are related through common control, including when one borrower controls another, and (ii) substantial financial interdependence exists between or among the borrowers. In the circumstances described above, the LLCs are commonly controlled by the Investor. However, substantial financial interdependence does not exist either between any LLC and the Investor or between LLCs. As noted above, substantial financial interdependence is deemed to exist between borrowers when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Here, most of the gross expenditures of the LLCs are debt service payments to the bank and most of the gross receipts of the LLCs are revenues from the sale of electricity. Further, revenue from an LLC does not account for a significant proportion of the Investor's annual gross receipts.

Finally, your inquiry sets forth a hypothetical circumstance. In any particular transaction, the bank may have many facts and circumstances to consider. As noted above, under the facts and circumstances prong of the common enterprise test (Facts & Circumstances Prong), loans may be combined when the bank (or the OCC, upon review) determines that a common enterprise exists based on an evaluation of the facts and circumstances of particular transactions. The Facts & Circumstances Prong is primarily designed to ensure that loans to separate borrowers may be combined even in a case in which the per se provisions of 12 C.F.R. § 32.5(b) and (c) are not triggered.[13] The Facts & Circumstances Prong means that the application of a per se prong is not necessary for there to be a common enterprise combination.[14]

[12] The term "guarantor" is not defined in the lending limit statute or regulation. A guarantor's obligation can be described as a "promise to answer for the payment of some debt, or the performance of some duty, in case of the failure of another who is liable in the first instance." *See* Black's Law Dictionary, 8th ed., 2004.

[13] *See* OCC Interpretive Letter No. 563, reprinted in [1991-1992 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,314 (Sept. 6, 1991) (citing final rule at 48 Fed. Reg. 15487 (Apr. 12, 1983)) (Interpretive Letter No. 563).

[14] *Id*. As noted in Interpretive Letter No. 563, the courts have supported this approach, acknowledging the U.S. Supreme Court's view that "the proof that the loans are in fact excess to one borrower often must be found in circumstances, and latitude must be allowed in adducing such proof." *Hughes v. Reed*, 46 F.2d 435, 442 (10th Cir. 1931) (quoting *Corsicana Nat'l Bank v. Johnson*, 251 U.S. 68, 73 (1919)).

As with other loans that involve commonalities between borrowers, before making wind tower loans to separate LLCs, banks should consider whether the facts and circumstances of the particular transactions mean that the loans represent in combination a single risk for lending limit purposes. Facts and circumstances that a bank may need to consider for wind tower loans include whether an Investor has created separate legal entities to avoid the lending limit in furtherance of a single common business, the nature of transactions between the Investor and the LLCs,[15] the level of operational and transactional interdependence that exists between the LLCs, and the geographic diversity of the wind generation facilities.

Independently from the applicability of the lending limit and its combination rules, loans made by national banks must be consistent with safe and sound banking practices.[16] Banks engaging in wind tower financings should require from potential borrowers, and be able to document for OCC examiners, pertinent data supporting these transactions.[17] In addition, strong transactional and concentration risk mitigation practices should be in place and will be assessed during examinations. Safeguards that the lender should consider include, but are not limited to, an appropriate level of investor equity contribution, guarantees from LLC shareholders, lender control over proceeds from the sale of electricity, ongoing monitoring of market prices and dynamics to assess sufficiency of the income stream, and measurement of geographic and aggregate concentration levels regardless of the combinability of the transactions for lending limit purposes.

This response is based solely on the facts described above and any change in the facts could require a different result. We trust the foregoing is responsive to your inquiry. If you have any questions, please contact Jonathan Fink, Special Counsel, Bank Activities & Structure, at (202) 874-5300.

Sincerely,

/s/

James F. E. Gillespie, Jr.
Deputy Chief Counsel

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[15] The direct benefit test would cause loans to LLCs to be combined and attributed to the Investor when loan proceeds are transferred to the Investor in transactions that are other than bona fide arm's length acquisitions of property, goods or services. *See* above note 5 and associated text.

[16] For example, a concentration of loans can constitute an unsafe and unsound practice.

[17] *See, e.g.*, *Community Wind Financing, A Handbook by the Environmental Law & Policy Center* (rev. Mar. 24, 2005) available at http://www.elpc.org/energy/ELPCCommunityWindFinancing2005.pdf (noting industry practice as to information expected by lenders including as to project management expertise, risk management plan, feasibility plans, off-take plan, wind monitoring, interconnection, zoning, turbine operation and maintenance).