Office of the Comptroller of the Currency

Washington, DC 20219

Interpretive Letter #1139
November 2013

November 13, 2013

Re: Request for Legal Opinion from **[** ***Bank, City, State*** **]**, on Financing Proposal

Dear **[ ]**:

This letter responds to your request on behalf of **[ ]** ("Bank"), concerning the Bank's proposal to provide project financing for a renewable energy solar project located in **[ ]** ("Facility"). Consistent with industry practice and at the request of the Facility's sponsor, the proposed project financing would be structured as an investment in the Facility's owner ("Company") to permit the Bank to receive federal renewable energy tax credits. Receipt of these tax credits, which Congress has enacted to encourage the development and financing of renewable energy facilities, would permit the Bank to reduce the cost of financing provided for the Facility. For the reasons discussed below, we find that the Bank may provide the financing for the Facility as described.

The Bank's decision to extend financing for the Facility would be based upon a full credit review of the proposed transaction. This creditworthiness determination would be made pursuant to a full credit review of the transaction and would be subject to the Bank's standard loan underwriting criteria, including an assessment of a variety of project sensitivities based on various risk scenarios to ensure a reasonable, predictable rate of return commensurate with the risk of the transaction and the various risk scenarios.[1] This credit analysis would demonstrate that the Bank recoups its investment in a reasonable period of time (including consideration of tax credits and depreciation benefits).[2] The Bank represents that it would not advance funds until it determines the creditworthiness of the Facility under these criteria. The Bank would be

[1] The Bank represents that it would not provide financing until the Facility is ready to be "placed into service." As a result, the Bank would not take on any construction risk.

[2] The Bank represents that its credit analysis would not place undue reliance on disposition of its interest following expiration of the tax credits.

repaid through receipt of the tax benefits and cash flow generated by the Facility. In order to take advantage of the available federal tax credits, if the financing is approved, the Bank would structure the financing by acquiring an approximately 70 percent membership interest in the Company.[3] The remaining interests would be held by the Facility's sponsor, which would serve as the Company's managing member.[4]

The Bank represents that management, operation, and maintenance of the Facility would be the responsibility of the Company, with day-to-day operations handled through an operations and maintenance contract with an experienced third-party project manager. The Bank represents that it would not participate in the operation of the Facility, the production of the solar energy, or the sale of the solar energy.[5] Energy output would be contractually sold on a long-term basis to creditworthy parties. The Bank would have a variety of remedies available if the Facility were to perform poorly. If the Bank wished to extricate itself should the Facility become distressed, the Bank could do so by selling its interest in the Company. The Bank represents its understanding that investors have expressed interest in acquiring interests in solar facilities after the tax benefits have been exhausted.

A national bank may engage in activities that are part of, or incidental to, the business of banking. Twelve U.S.C. § 24(Seventh) provides national banks with broad authority to make loans or other extensions credit. Both the OCC and the courts have held that permissible loan-equivalent transactions can take different and non-traditional forms in order to accommodate the demands of the market; the economic substance of the transaction, rather than its form, guides the analysis of whether the transaction is a permissible lending activity.[6] Here, the alternative

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[3] The Facility's developer is seeking to secure an initial round of construction financing with the North American Development Bank ("NADB"). The NADB was created by the governments of the United States and Mexico in a joint effort to work with communities and project sponsors to develop, finance, and build affordable and self-sustaining projects to preserve and enhance environmental conditions and the quality of life of people living along the U.S.-Mexico border. As a condition precedent to disbursement of NADB financing, NADB requires a facility to have a firm commitment for project financing (which the Bank proposes to provide). The Bank represents that the NADB construction financing will be converted to NADB term loan financing no later than the final funding by the Bank of its project financing.

[4] To protect the Bank's ability to preserve the tax credits, the Bank represents that it contractually would be entitled to indemnification for breaches of tax representations and warranties. The parent of the managing member would guarantee the indemnification.

[5] The Bank represents that neither it nor any U.S. affiliate engages in electricity or energy trading activities. The Bank further represents its determination that the Company is an operating company and not an investment company that relies on an exemption under the Investment Company Act of 1940.

[6] *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) (national banks may acquire, own, and lease automobiles and heavy equipment; when the economic characteristics of a lease are substantially similar to a loan, the lease is deemed to be an exercise of the bank's lending powers); Interpretive Letter (November 4, 1994) (available in Lexis-Nexis) (bank provided financing to owners of natural gas leases by acquiring interest in business trust that owned working interests in the leases; acquisition of interest in trust that held leases necessary for the bank to be eligible to receive federal tax credits).

form of the transaction does not change the fundamental substance of the Bank's role as a provider of credit.

National banks provide financing for renewable energy facilities in a variety of structures. For example, in Corporate Decision 2012-06 (February 28, 2012), we authorized the the provision of lease financing for a wind power facility. Similarly, in Community Development Investment Letter 2009-1 (February 17, 2009), we permitted a national bank to provide financing for a solar energy facility by acquiring an interest in a limited liability company that leased the facility.[7] The special characteristics and risk management issues associated with the provision of financing to renewable energy facilities are similar in the instant proposal.

Most fundamentally, in providing financing for renewable energy facilities, a bank extends the funds upon its analysis of the likelihood that the funds would be repaid with a reasonable return. Thus, the Bank represents that its decision whether to enter into the transaction would be based upon a full credit review of the borrower and that the proposed transaction would be made pursuant to the Bank's standard loan underwriting criteria. The governing agreement would entitle the Bank to payments comprised of a proportional share of the revenue from the sale of electricity by the Facility, which is expected to result in periodic payments from a long-term production purchase contract with creditworthy parties.[8] The Bank further represents that the documents governing the transaction would contain many of the same terms, conditions, and covenants typically found in lending and lease financing transactions, including restrictions on the borrower with respect to the incurrence of liens and additional debt, merger, consolidation or divesting of assets, and typical reporting and operating covenants by the borrower.[9]

In total, other than the form of the interest the bank acquires as the vehicle to provide financing, the proposed financing is substantially identical to a loan transaction. Therefore, we conclude that the Bank may provide project financing to the Facility as proposed. In providing the financing, the Bank will indirectly acquire an interest in the leases in real property underlying the Facility.[10] Because structuring the financing as a membership interest is essential to the

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[7] *See also* Interpretive Letter No. 1048 (December 21, 2005).

[8] The Bank represents that, if it has not received the pre-negotiated rate of return by a date certain, it would be entitled to receive substantially all the cash flow generated by the Facility until it has received its rate of return.

[9] The Bank represents that it would recognize this transaction internally as a loan and would include the proposed financing to the Facility in the calculation of its legal lending limits.

[10] The Bank also would indirectly acquire interests in the Facility's equipment, such as solar panels. We have previously determined that wind turbines and ancillary equipment are not real property for purposes of 12 U.S.C. § 29, and we similarly conclude that the solar equipment here is not real property under 12 U.S.C. § 29. *See* Corporate Decision 2012-06, *supra* (stating that whether property is real or personal for purposes of 12 USC § 29 is a matter of federal law, and concluding that wind turbines are personal property). Solar panels are treated as equipment or personal property for federal income tax

availability of the tax credits to the Bank and thereby integral to the material terms of the financing, acquisition of the leasehold interests is merely incidental to the financing. Pursuant to the terms of the financing, the Bank would not be able to make use of the leasehold interests, other than as the location of the Facility, and the Bank represents that it would not rely on the leasehold interests when making a decision whether to provide the financing. Therefore, we conclude that the indirect acquisition of these interests is not inconsistent with the purposes underlying 12 U.S.C. § 29.[11]

Accordingly, in consideration of the foregoing analysis, based upon the facts and representations provided by the Bank and subject to the conditions below, we conclude that the Bank may provide financing for the Facility in the manner stated. The authority to provide such financing is subject to the following conditions:

- Prior to executing the financing agreements and providing funds, the Bank must notify its Examiner-in Charge, in writing, of the proposed transaction and must receive written notification of supervisory non-objection, based on an evaluation of the Bank's risk management and measurement systems and controls to enable the Bank to conduct the financing activity in a safe and sound manner, and an evaluation of any other supervisory considerations relevant to the transaction. Such a notification should include an assessment and discussion of the financing's risks and expected rate of return.

- Prior to providing financing, the Bank must verify and confirm the appropriate accounting treatment for the proposed financing.

- Prior to providing the financing, the Bank must ensure that insurance coverage is in place to account for the risk of damage to or destruction of the Facility.

- Pursuant to the terms of the financing, the unaffiliated minority owner of the Company must have a call option to purchase the project at fair market value after a pre-negotiated amount of time passes or after the Bank receives a pre-negotiated rate of return from the financing.

- The Bank must limit the total dollar amount of this and similar financing transactions for renewable energy projects to no more than three percent of its capital and surplus.[12]

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purposes. *Compare* 26 U.S.C. § 168(e)(3)(vi) (special depreciation for equipment, including solar equipment) *with* § 168(e)(2) (real property).

[11] *See Union Bank v. Matthews,* 98 U.S. 621, 626 (1878) (stating that purposes underlying section 29 are to prevent banks from speculating by acquiring large masses of real property to be held long-term); Interpretive Letter No. 966 (May 12, 2003) (acquisition of circumscribed interest in real property, where integral to the provision of permissible services or activities, is not inconsistent with the restrictions underlying section 29); Corporate Decision 99-07 (March 29, 1999) (bank may acquire circumscribed interest in real property in furtherance of a permissible banking activity).

[12] *See* 12 C.F.R. 5.3(d) (definition of "capital and surplus"). In addition, the Bank must engage in the proposed activity in a safe and sound manner. Under 12 U.S.C. § 1831p-1 and 12 C.F.R. 30, the OCC

Our conclusions herein are specifically based on the Bank's representations and written submissions describing the facts and circumstances of the subject transactions. Any change in facts or circumstances or failure to comply with the above conditions could result in a different conclusion**,** including a determination that the Bank may no longer permissibly engage in the proposed financing transaction.

This approval and the activities and communications by OCC employees in connection with this approval, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

Sincerely,

/s/

Amy S. Friend
Senior Deputy Comptroller
and Chief Counsel

may issue to a bank a determination and notification of failure to meet the safety and soundness standards (set forth in Appendix A to Part 30) and require the bank to submit a safety and soundness compliance plan.