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TITLE 7--AGRICULTURE

CHAPTER XVII--RURAL UTILITIES SERVICE, DEPARTMENT OF AGRICULTURE

PART 1717_POST-LOAN POLICIES AND PROCEDURES COMMON TO INSURED AND GUARANTEED ELECTRIC LOANS--Table of Contents

Subpart D_Mergers and Consolidations of Electric Borrowers

Sec. 1717.150 General.

Source: 61 FR 66871, Dec. 19, 1996, unless otherwise noted.

(a) This subpart establishes RUS policies and procedures for mergers of electric borrowers. These policies and procedures are intended to provide borrowers with the flexibility to negotiate and enter into mergers that offer advantages to the borrowers and to rural communities, and adequately protect the integrity and credit quality of RUS loans and loan guarantees.

(b) Consistent with prudent lending practices, the maintenance of adequate security for RUS loans and loan guarantees, and the objectives of the Rural Electrification Act of 1936, as amended, (7 U.S.C. 901 et seq.) (RE Act), RUS encourages electric borrowers to consider mergers when such action is likely to contribute, in the long-term, to greater operating efficiency and financial soundness. Borrowers are specifically encouraged to explore mergers that are likely to enhance the ability of the successor to provide reliable electric service at reasonable cost to RE Act beneficiaries.

(c) Pursuant to the loan documents and RUS regulations, certain mergers are subject to RUS approval. See Sec. 1717.615.

(d) Since RUS must take action in order to advance funds and otherwise conduct business with a successor, RUS encourages borrowers to consult RUS early in the process regardless of whether RUS approval of the merger is required. RUS will provide technical assistance and guidance to borrowers to help expedite the processing of their requests and to help resolve potential problems early in the process.

Sec. 1717.151 Definitions.

The definitions set forth in 7 CFR 1710.2 are applicable to this subpart unless otherwise stated. In addition, for the purpose of this subpart, the following terms shall have the following meanings:

Active borrower means an electric borrower that has, on the

effective date, an outstanding insured or guaranteed loan from RUS for rural electrification, and whose eligibility for future RUS financing is not restricted pursuant to 7 CFR part 1786.

Active distribution borrower means an electric distribution borrower that has, on the effective date, an outstanding insured or guaranteed loan from RUS for rural electrification, and whose eligibility for future RUS financing is not restricted pursuant to 7 CFR part 1786.

Consolidation. See Merger.

Coverage ratios means collectively TIER, OTIER, DSC and ODSC, as these terms are defined in 7 CFR 1710.2.

Effective date means the date a merger is effective pursuant to applicable state law.

Former distribution borrower means any organization that

(1) Sells or intends to sell electric power and energy at retail;
(2) At one time had an outstanding loan made or guaranteed by RUS, or its predecessor the Rural Electrification Administration (REA) for rural electrification; and (3) Either repaid such loans at face value or prepaid pursuant to 7 CFR part 1786.

Loan documents means the mortgage (or other security instrument acceptable to RUS), the loan contract, and the promissory note(s) entered into between the borrower and RUS.

Merger means: (1) A consolidation where two or more companies are extinguished and a new successor is created, acquiring the assets, liabilities, franchises and powers of those passing out of existence;

(2) A merger where one company is absorbed by another, the former ceasing to exist as a separate business entity, and the latter retaining its own identity and acquiring the assets, liabilities, franchises and powers of the former; or

(3) A transfer of mortgaged property by one company to another where the transferee acquires substantially as an entirety the assets, liabilities, franchises, and powers of the transferor.

New loan means a loan to a successor approved by RUS on or after the effective date.

Preexisting loan means a loan to a borrower approved by RUS prior to, and outstanding on the effective date.

Successor means the entity that continues as the surviving business entity as of the effective date, and acquires all the assets, liabilities, franchises, and powers of the entity or entities ceasing to exist as of the effective date.

Transitional assistance means financial relief provided to borrowers by RUS during a limited period of time following a merger.

Sec. 1717.152 Required documentation for all mergers.

In order for RUS to advance funds, send bills, and otherwise conduct business with a successor, the documents listed in this section must be submitted to RUS regardless of the need for RUS approval of the merger. Borrowers are responsible for ensuring that these documents are received by RUS in timely fashion. In cases of mergers that require RUS approval, or cases where borrowers must submit requests for transitional assistance, the documents listed in this section may be combined with the documents required by Sec. Sec. 1717.157 and/or 1717.160 where appropriate.

(a) Prior to the effective date, borrowers must submit:

(1) A transmittal letter on corporate letterhead signed by the manager of each active borrower that is a party to the proposed merger indicating the borrower's intention to merge and tentative timeframes,

including the proposed effective date;

(2) An original certified board resolution from each party to the proposed merger affirming the board's support of the merger;

(3) All documents necessary to evidence the merger pursuant to applicable law. Examples include plan of merger, articles of merger, amended articles of incorporation, bylaws, and notices and filings required by law. These documents may be copies of documents filed elsewhere, unless otherwise specified by RUS; and

(4) A letter addressed to the Administrator from the counsel of at least one of the active borrowers briefly describing the merger and indicating the relevant statutes under which the merger will be consummated.

(b) On or after the effective date, borrowers must submit:

(1) An opinion of counsel from the successor addressing, among other things, any pending litigation, proper authorization and consummation of the merger, proper filing and perfection of RUS' security interest, and all approvals required by law. RUS will provide the form of the opinion of counsel to the successor;

(2) A letter signed by the manager of the successor advising RUS of the effective date of the merger; the corporate name, address, and home number; the names of the officers of the successor; and the taxpayer identification number; and

(3) Evidence of proper filing and perfection of RUS' security interest, as instructed by RUS, and an executed loan contract.

Sec. 1717.153 Transitional assistance.

RUS recognizes that short-term financial stresses can follow even the most beneficial mergers. To help stabilize electric rates, enhance the credit quality of outstanding loans made or guaranteed by the Government, and otherwise ease the transition period before the long-term efficiencies and economies of a merger can be realized, RUS may approve one or more types of transitional assistance to a successor under the conditions set forth in this part.

Sec. 1717.154 Transitional assistance in connection with new loans.

Requests for transitional assistance in connection with new loans may be submitted to RUS no later than the loan application.

(a) *Loan processing priority.* (1) RUS loans are generally processed in chronological order based on the date the complete application is received in the regional or division office. At the borrower's request, RUS may offer loan processing priority for the first loan to a successor, provided that the loan is approved by RUS not later than 5 years after the effective date of the merger. In considering the request, the Administrator will take into account, among other factors, the amount of the loan application, whether there is a significant backlog in pending loan applications, the impact that loan priority would have on the backlog, the savings and efficiencies to be realized from the merger and the relative importance of loan priority to facilitating the merger. The Administrator may, in his or her sole discretion, grant or decline to grant priority, or grant priority for a limited amount of the loan application while deferring for later consideration the remainder of the application.

(2) For any subsequent loans approved during those 5 years, RUS may offer loan processing priority. In reviewing requests for loan processing priority on subsequent loans, RUS will consider the loan

authority for the fiscal year, the borrower's projected cash flows, its electric rates and rate disparity, and the likely mitigation effects of priority loan processing. See 7 CFR 1710.108 and 1710.119.

(3) Loan processing priority is available following any merger where at least one of the merging parties is an active borrower.

(b) Supplemental financing. (1) RUS generally requires that an applicant for a municipal rate loan obtain a portion of its debt financing from a supplemental source without an RUS guarantee. See 7 CFR 1710.110. RUS will, at the borrower's request, waive the requirement to obtain supplemental financing for the first RUS loan approved after the effective date if that first loan is a municipal rate loan whose loan period does not exceed 2 years, and the loan is approved by RUS not later than 5 years after the effective date. For any subsequent loans approved during these 5 years, or if the borrower requests a loan period longer than 2 years, RUS may, subject to the availability of loan funds, waive or reduce the amount of supplemental financing required. In reviewing requests to reduce or waive supplemental financing on subsequent loans or on loans with a loan period longer than 2 years, RUS will consider the differences in interest rates between RUS and supplemental loans and the impacts of this difference on the borrower's projected cash flows and its electric rates and rate disparity. If significant differences would result, the waiver will be granted.

(2) Waiver of supplemental financing may be available if:

- (i) All parties to the merger are active distribution borrowers, or
- (ii) At least one of the merging parties is an active distribution borrower, all merging parties are either active distribution borrowers or former distribution borrowers, and the merger is effective after December 19, 1996.

(c) Reimbursement of general funds and interim financing. (1) Borrowers may request RUS loan funds to reimburse general funds and/or interim financing used to finance equipment and facilities included in a RUS approved construction work plan or amendment if the construction was completed immediately preceding the current loan period. This reimbursement period is generally limited to 24 months. See 7 CFR 1710.109. RUS may, in connection with the first RUS loan approved after the effective date, approve a reimbursement period of up to 48 months prior to the current loan period if the loan is approved not later than 5 years after the effective date. In reviewing requests for this longer reimbursement period, RUS will consider the stresses that the transaction and other costs of entering into the merger places on the borrower's rates and cash flows, and the mitigating effects of more generous reimbursement.

(2) A longer reimbursement period may be available if:

- (i) All parties to the merger are active distribution borrowers, or
- (ii) At least one of the merging parties is an active distribution borrower, all merging parties are either active distribution borrowers or former distribution borrowers, and the merger is effective after December 19, 1996.

Sec. 1717.155 Transitional assistance affecting new and preexisting loans.

Requests for transitional assistance affecting new and preexisting loans must be received by RUS no later than 2 years after the effective date.

(a) Section 12 deferments. (1) Section 12 of the RE Act (7 U.S.C. 912) allows RUS to extend the time of payment of interest or principal

of RUS loans. Section 12 deferments do not extend the final maturity of the loan; lower payments during the deferment period result in higher payments later. Therefore, RUS may approve a Section 12 deferment of loan payments of up to 5 years only if such deferments will help to avoid substantial increases in retail electric rates during the transition period, without placing borrowers in financial stress after the deferment period.

(2) Section 12 deferment may be available following any merger where at least one of the merging parties is an active borrower.

(b) *Coverage ratios.* Required levels for coverage ratios are set forth in 7 CFR 1710.114 and in the loan documents. RUS may approve a plan, on a case by case basis, that provides for a phase-in period for these coverage ratios of up to 5 years from the effective date. Under such a plan the successor would be permitted to project and achieve lower levels for one or more of these coverage ratios during the phase-in period.

(1) A phase-in plan for coverage ratios must provide a pro forma level for each ratio during each year of the phase-in period and be supported by a financial forecast covering a period of not less than 10 years from the effective date of the merger. The plan must demonstrate that a minimum TIER level of 1.00 will be achieved in each year, that trends will be generally favorable, that the borrower will achieve the levels required in its loan documents and RUS regulations by the end of the phase-in period, and that these levels will be maintained in subsequent years.

(2) In reviewing phase-in plans for coverage ratios, RUS will review rates, rate disparity, and likely mitigating effects of the proposed phase-in plan.

(3) The borrower is responsible for obtaining approvals of Supplemental lenders.

(4) Upon RUS approval of a phase-in plan, the levels in that plan will be substituted for the levels required in the borrower's preexisting loan documents and will be incorporated in any new loan or security documents.

(5) A phase in plan for coverage ratios may be available if:

- (i) All parties to the merger are active distribution borrowers, or
- (ii) At least one of the merging parties is an active distribution borrower, all merging parties are either active distribution borrowers or former distribution borrowers, and the merger is effective after December 19, 1996.

Sec. 1717.156 Transitional assistance affecting preexisting loans.

The fund advance period for an insured loan, which is the period during which RUS may advance loan funds to a borrower, terminates automatically after a specific period of time. See 7 CFR 1714.56. If, on the effective date the original fund advance period or the fund advance period as extended pursuant to 7 CFR 1714.56(c), on any preexisting RUS loan to any of the active borrowers involved in a merger has not terminated, such fund advance period shall be automatically lengthened by 2 years. On the borrower's request RUS will prepare documents necessary for the advance of loan funds. RUS will prepare documents for the borrower's execution that will reflect this extension and will provide the legal authority for RUS to advance funds to the successor.

Sec. 1717.157 Requests for transitional assistance.

(a) If the merger requires RUS approval, the borrower should, where possible, indicate that it desires transitional assistance at the time it requests approval of the merger. The formal request for transitional assistance must be received by RUS as specified in Sec. Sec. 1717.155 and 171.156. Documents listed in this section may be combined with the documents required by Sec. Sec. 1717.152 and/or 1717.160 where appropriate. If the request for transitional assistance is submitted at the same time as a loan application, documents listed in this section may be combined with the loan application documents where appropriate. See 7 CFR part 1710, subpart I. A request for transitional assistance must include:

(1) Transmittal letter(s) formally listing the types of transitional assistance requested. If the request is submitted before the effective date, a transmittal letter must be signed by the manager of each party to the transaction. If the request is submitted on or after the effective date, a transmittal letter must be signed by the manager of the successor. Transmittal letter(s) must be signed originals on corporate letterhead stationery;

(2) Board resolution(s). If the request is submitted before the effective date, a separate board resolution must be submitted from each entity involved in the merger. If the request is submitted on or after the effective date, a board resolution from the successor must be submitted. Each board resolution must be a certified original;

(3) A merger plan, financial forecasts, and any available studies such as net present value analyses showing the anticipated costs and benefits of the merger and likely timeframes for the merger. The merger plan must clearly identify those benefits that cannot be achieved without a merger, and those benefits that can be achieved through other means;

(4) If the transitional assistance requires RUS approval, the type and extent of the mitigation that the transitional assistance is expected to provide; and

(5) Other information that may be relevant.

(b) Borrowers are responsible for ensuring that requests for transitional assistance are complete and sound in form and substance when they are submitted to RUS. After submitting a request, borrowers shall promptly notify RUS of any changes or events that materially affect the request or any information in the request.

(c) In considering whether to approve requests for transitional assistance, RUS will evaluate the costs and benefits of the merger; the type and extent of the likely transitional stress; whether the transitional assistance requested is likely to materially mitigate such stress; and the likely impacts on electric rates and on the security of RUS loans. Review factors applicable to each type of transitional assistance are set forth in Sec. Sec. 1717.154-1717.156.

Sec. 1717.158 Mergers with borrowers who prepaid RUS loans.

In some cases, an active distribution borrower may merge with a borrower that has prepaid RUS debt at a discount pursuant to 7 CFR part 1786, and whose eligibility for future RUS financing is thereby restricted. During the period when the restrictions on future financing are in effect, the successor will be eligible for RUS loans to finance facilities to serve consumers located in the territory that was served by the active distribution borrower immediately prior to the effective date, provided that other requirements for loan eligibility are met.

Sec. 1717.159 Applications for RUS approvals of mergers.

If a proposed merger requires RUS approval according to RUS regulations and/or the loan documents executed by any of the active borrowers involved, the application must be submitted to RUS not later than 90 days prior to the effective date of the proposed borrower action. A distribution borrower should consult with its assigned RUS general field representative, and a power supply borrower with the Director, Power Supply Division for general information prior to submitting the request.

Sec. 1717.160 Application contents.

An application for RUS approval of a merger must include the documents listed in this section. Documents listed in this section may be combined with the documents required by Sec. Sec. 1717.152 and/or 1717.157 where appropriate.

(a) *Transmittal letters* signed by the managers of all borrowers and non-borrowers who are parties to the proposed merger. These letters must include the actual corporate name, address, and taxpayer identification number of all parties to the proposed merger. The transmittal letters must be signed originals on corporate letterhead stationery.

(b) *Resolutions from the boards of directors* of all borrowers and non-borrowers who are parties to the proposed merger. This document is the formal request by each entity for RUS approval of the proposed merger. The board resolution must include a description of the proposed merger, including timeframes, and authorization for RUS to release appropriate information to supplemental or other lenders, and for these lenders to release appropriate information to RUS. Each board resolution must be a certified original.

(c) *Evidence* that the proposed merger will result in a viable entity, and that the security of outstanding RUS loans will not be adversely affected by the action. This evidence shall include financial forecasts, and any available studies such as net present value analyses covering a period of not less than 10 years from the effective date of the merger, as well as information about any threatened actions by other parties that could adversely affect the financial condition of any of the parties to the proposed merger, or of the successor. Such threatened actions may include annexations or other actions affecting service territory, loads, rates or other such matters.

(d) *Regulatory information* about pending federal or state proceedings pertaining to any of the parties that could have material effects on the successor.

(e) *Rate information.* Distribution and power supply borrowers shall submit schedules of proposed rates after the merger, including the effects of the proposed action on rates and the status of any pending rate cases before a state regulatory authority. The rates of power supply borrowers are subject to RUS approval. If rates are not projected to change after the merger, a statement to that effect will suffice.

(f) *Area coverage and line extension policies.* If any distribution systems are parties to the proposed merger, a statement of proposed area coverage and line extension policies for the successor.

Sec. 1717.161 Application process.

(a) Borrowers are responsible for ensuring that their applications for RUS approval of a merger are complete and sound in form and

substance when they are submitted to RUS. After submitting an application, borrowers shall promptly notify RUS of any changes or events that materially affect the application or any information in the application.

(b) In reviewing borrower requests for approval of mergers, RUS will consider the likely effects of the action on the ability of the successor to provide reliable electric service at reasonable cost to RE Act beneficiaries and on the security of outstanding RUS loans. Among the factors RUS will consider are whether the proposed merger is likely to:

(1) Contribute to greater operating efficiency and financial soundness;

(2) Mitigate high electric rates and or rate disparity;

(3) Help borrowers to diversify their loads or otherwise hedge risks;

(4) Have beneficial effects on rural economic development in the community served by the borrower, such as diversifying the economic base or alleviating unemployment; and

(5) Provide other benefits consistent with the purposes of the RE Act.

(c) RUS will not approve a merger if, in the sole judgment of the Administrator, such action is likely to have an adverse effect on the credit quality of outstanding loans made or guaranteed by the Government. RUS will thoroughly review each request for approval of such action, including review of the feasibility and security of outstanding Government loans according to the standards in 7 CFR 1710.112 and 1710.113, respectively, and in other RUS regulations.

(d) RUS will keep the borrowers apprised of the progress of their applications.