Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #811
January 1998
12 U.S.C. 24(7)18
12 U.S.C. 24(7)1

December 18, 1997

John W. Alderman, III
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P.O. Box 4168
Charleston, West Virginia 25364-4168

Dear Mr. Alderman:

This responds to your request that the Office of the Comptroller of the Currency ("OCC") confirm that the proposed acquisition of [ ] ("Printing Company") by [ ], [*City, State*] ("Bank") is permissible. Based on the information and representations provided, and for the reasons discussed below, we agree with your conclusion that the proposed acquisition and contemplated activities of the Printing Company would be permissible under the National Bank Act.

Background

The Bank and its affiliates currently contract with the Printing Company and other third parties for bank printing and related design services which include the printing of checks, forms, marketing materials, and similar items. The Printing Company also offers similar services and supplies to other customers, some of whom are not financial institutions. The Bank proposes to acquire the Printing Company and to operate it as a division of the Bank. The Bank's primary business objective in acquiring the Printing Company is to reduce its printing costs and achieve greater control over the production of its printed materials. The Bank believes that the acquisition of an existing printing business, including its trained employees and assets, would achieve these objectives more efficiently and with less risk than acquiring printing capability de novo.

Following its acquisition, the Printing Company would continue to provide printing services to the Bank and its affiliates as described. Additionally, the Bank plans to use the Printing Company's "excess capacity" to provide printing services to third-parties, including non-financial entities. This excess capacity would exist in part because initially the Bank and its

affiliates will not consume all of the printing and design capacity of the Printing Company. Specifically, the Bank expects that immediately after the acquisition approximately 80-85% of the Printing Company's printing and design capacity will be consumed by the businesses of the Bank and its affiliates. However, the Bank expects that this excess capacity in the Printing Company will decrease over time as the operations of the Bank and its affiliates expand and as their need for printing services increase concomitantly. Although the precise amount and timing of this reduction in excess capacity cannot be predicted with certainty, based on current growth rates and assuming no increase in the Printing Company's capacity, the Bank believes that the initial excess would be consumed by its operations and those of its affiliates within five years.[1]

The Bank reports that the owners of the Printing Company will not sell to the Bank less than 100% of the Company, and the Bank does not believe that it can cost-effectively acquire assets and attract employees de novo that would adequately substitute for the assets, employees and expertise that it could acquire through the Printing Company. The Bank also states that, assuming it did not need the excess capacity for anticipated future internal growth, it would be unable following the acquisition of the Printing Company to segregate and divest the excess printing capacity since substantially all of the excess is represented by individual, indivisible assets (e.g., presses, printers, copiers, and other fixed assets) and employees with special expertise. The Bank represents that simply divesting or not using the excess capacity would result in substantial loss to the Bank from increased overhead and reduced return on assets.

Discussion

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes. . . .

12 U.S.C. § 24 (Seventh).

The Supreme Court has expressly held that the "business of banking" is not limited to the enumerated powers in 12 U.S.C. § 24 (Seventh), but encompasses more broadly activities that are part of the business of banking. See NationsBank of North Carolina, N.A., v Variable Life Annuity Co., 115 S. Ct. 810, 814 n.2 (1995) ("VALIC"). The VALIC decision further established that banks may engage in the activities that are incidental to the enumerated powers as well as the broader "business of banking."

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[1] OCC recognizes that projections of future needs of printing services cannot be made with complete accuracy because, among other reasons, unforseen changes in technology could change patterns of internal consumption of such services.

Prior to VALIC, the standard that was often considered in determining whether an activity was incidental to banking was the one advanced by the First Circuit Court of Appeals in Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972) ("Arnold Tours"). The Arnold Tours standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its *express* powers under the National Bank Act." Arnold Tours at 432 (emphasis added). Even prior to VALIC, the Arnold Tours formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. OCC Interpretive Letter 494 (December 20, 1989). The VALIC decision, however, has established that the Arnold Tours formula provides that an incidental power includes one that is convenient and useful to the "business of banking," as well as a power incidental to the express powers specifically enumerated in 12 U.S.C. § 24(Seventh).

Printing Services for the Bank and its Affiliates

The acquisition and operation of the Printing Company to provide printing services for the Bank and its affiliates are permissible for a national bank under 12 U.S.C. § 24(Seventh). With respect to printing services for the Bank, the proposed activity is "convenient" and "useful" to the business of banking. Some printing operations will be used directly for banking services, e.g., to provide forms used by the Bank in its lending and deposit functions. Indeed, the OCC has previously concluded that the printing of checks, drafts, loan payment coupons, and similar documents for use in the national bank's business is a permissible incidental activity for a national bank. See Letter from Mary Wheat (April 7, 1988) (Unpublished).

Other printing activities of the Company will not be used directly for banking activities, but are permissible incidental activities because they facilitate, support and, hence, are "necessary to" the operation of the Bank as a business. Examples of these would be the design and printing of internal personnel forms and telephone message pads for the Bank. These printing services fall within the category of permissible incidental activities of national banks that are not incident to specific banking services or products, but rather to the operation of the bank as a business: they facilitate general operation of the bank as a business enterprise. Examples of these facilitating activities include hiring employees, issuing stock to raise capital, owning or renting equipment, borrowing money for operations, purchasing the assets and assuming the liabilities of other financial institutions. While no express grants of authority to conduct these activities exist, various federal statutes have implicitly recognized and regulated these business activities of national banks. For example, the statutes refer to limits on persons who can serve as bank employees.[2] In each case, the statutes have assumed the existence of the corporate power to conduct the activity. These powers are incidental to the general grant of power to conduct a "business" under 12 U.S.C. § 24(Seventh) and do not need express enumeration.[3]

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[2] See, e.g., 12 U.S.C. § 78 (persons ineligible to be bank employees).

[3] Memorandum dated November 18, 1996, to Eugene A. Ludwig, Comptroller of the Currency, from Julie L. Williams, Chief Counsel, "Legal Authority for Revised Operating Subsidiary Regulation," reprinted at [1996-

Producing printed materials needed for the Bank's internal administration as a business is, thus, a permissible incidental activity.

Finally, providing printing services for affiliated banks (and for nonaffiliated banks) is part of the business of banking because it is a valid correspondent banking function. National banks have traditionally performed for other financial institutions an array of activities called "correspondent services." *United States v. Citizens and Southern Nat'l Bank*, 422 U.S. 86, 114-15 (1975). These correspondent activities are part of the business of banking. OCC Interpretive Letter No. 754, reprinted in [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-118 (Nov. 6, 1996). Among the permissible correspondent activities are designing and producing banking related forms and documents. *See* OCC Interpretive Letter No. 513, reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990).

Retained Excess Capacity

The Bank notes that acquisition of the Printing Company will provide more printing capacity than can be consumed initially by the Bank and its affiliates. Accordingly, it proposes to use this excess capacity to provide a limited amount of printing services for third parties. For the reasons below, this is a permissible use of retained excess capacity.

As noted above, a national bank may acquire a non-financial company where the company's non-financial operations are incidental to the production or distribution of banking products. In some cases the acquired company may have more productive capacity than can be currently used for banking operations. See, e.g., OCC Interpretive Letter No. 677, reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995) (acquisition of a financial services software company).

The OCC and the courts have long held that if a bank acquires excess capacity in good faith to meet the needs of the bank or its customers, the bank may use the excess capacity profitably even though the specific activities involving the excess capacity are not, themselves, part of or incidental to the business of banking. This doctrine has been applied to excess capacity in real

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1997 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 90-464 ("Williams Memo").

estate[4], electronic facilities[5], and non-electronic facilities[6]. Further, this doctrine applies to the acquisitions of companies as well as equipment and facilities. OCC Interpretive Letter No. 677, supra.

The excess capacity doctrine recognizes that a bank acquiring an asset in good faith to conduct its banking business should, under its incidental powers, be permitted to make full economic use of the acquired property if use of the property for purely banking purposes would leave the property underutilized. The underlying rationale is essentially that of avoidance of economic waste. The market price of the acquired property necessarily reflects its potential full economic use and if a bank cannot obtain that full economic value from owning the property, the bank would incur economic waste and could be unable to purchase the property it needs for its banking business. Thus, in the leading case of Brown v. Schleier, supra, the court observed:

> Nor do we perceive any reason why a national bank, when it purchases or leases property for the erection of a banking house, should be compelled to use it exclusively for banking purposes. If the land which it purchases or leases for the accommodation of its business is very valuable, it should be accorded the same rights that belong to other land owners of improving it in a way that will yield the largest income, lessen its own rent, and render that part of its funds which are invested in realty most productive.

Similarly, the OCC has said regarding excess computer capacity:

> If a bank . . . has legitimately acquired data processing equipment with excess capacity, it need not allow the excess capacity to go unused. Thus, the bank . . . may, incident to its legitimate acquisition of that equipment, sell the excess time even where the data processing services thus sold will not be data processing functions which are, of themselves, part of the business of banking. This allows a bank . . . to lower its costs of performing those data processing services which part of the banking business more profitable and competitive.

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[4] See Brown v. Schleier, 118 F. 981, 984 (8th Cir. 1902), aff'd, 194 U.S. 18 (1904); Wingert v. First National Bank, 175 F. 739 (4th Cir. 1909); Perth Amboy National Bank v. Brodsky, 207 F. Supp. 785, 788 (S.D.N.Y. 1962); and Unpublished letter from Comptroller James J. Saxon dated February 16, 1965.

[5] OCC Interpretive Letter No. 742, reprinted in [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-106 (Aug. 19, 1996) (excess capacity in Internet access); OCC Interpretive Letter No. 677, supra (excess capacity in software production and distribution); Unpublished letter from William Glidden dated June 6, 1986 (excess capacity in electronic security system); Unpublished letter from Stephen Brown dated December 20, 1989 (excess capacity in long line communications); and 12 C.F.R. 7.1019.

[6] Unpublished letter from Mary Wheat dated April 7, 1988 (excess capacity in acquired printing equipment); Unpublished letter from William Glidden dated 7/11/89 (excess capacity in messenger services); and Unpublished letter from Peter Liebesman dated December 13, 1983 (excess capacity in mail sorting machine).

Unpublished letter from Peter Liebesman, dated December 13, 1983 (hereinafter: the "Liebesman Letter").

In its excess capacity letters, OCC recognizes that good faith excess capacity can arise for several reasons. For example, the excess may be unavoidable where "due to the characteristics of the [desired equipment or facilities] available on the market, the capacity of the most practical optimal equipment [or facilities] available to meet the bank's needs may also exceed its precise needs." OCC Interpretive Letter No. 742, supra. See also, Liebesman Letter, supra; Unpublished letter from Mary Wheat dated April 7, 1988; and Unpublished letter from William Glidden dated June 6, 1986. With equipment, this can occur because the equipment is not marketed in a size that meets the specific needs of the bank. With a company, this can occur in good faith because, for example, (1) the acquisition of an existing company is more economical than acquiring or developing needed capability de novo, (2) the seller refuses to sell just the portion of the company the bank needs and, (3) as a practical matter, the purchasing bank is unable to divest the excess portion of the company without loss or injury because purchasers for that portion of the company cannot realistically be found at a price that would fully compensate the bank for its investment in the excess portion of the company.[7]

Retention of excess capacity may also be necessary for future expansion or to meet the expected future needs of the bank. OCC Interpretive Letter No. 677, supra; and Unpublished letter from Stephen Brown dated December 20, 1989. By way of analogy, national banks are permitted to acquire and to sell excess space in real property that they hold in good faith for future banking use. See, e.g., Unpublished letter from Comptroller James J. Saxon dated February 16, 1965 and Unpublished letter from Wallace Nathan dated July 22, 1986. Property acquired for future use can be retained if there is a "reasonable expectation that, in the foreseeable future, the property will be useful" for banking purposes. Unpublished letter from Thomas DeShazo dated August 6, 1975; Unpublished letter from Peter C. Kraft dated February 13, 1986; Unpublished Letter from John Powers dated December 23, 1986.[8]

Finally, good faith excess capacity can also arise after the initial acquisition of capacity thought to be fully needed for banking operations. This can occur due to a decline in level of

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[7] Merely ceasing the operations of the "excess" portion without a sale, even though it would save on variable costs, will frequently result in a loss where the "excess" portion produces net revenues. The purchasing bank will usually have paid a premium for the company based in part upon the net present value of that expected revenue stream which will be lost if the operation is simply ceased without sale.

[8] In light of the express statutory limitation on national bank holding of realty under 12 U.S.C. § 29, the OCC expects that a national bank will normally use real estate acquired for future expansion within five years. See 12 C.F.R. § 34.84. However, the appropriate period of time for expected consumption of non-realty excess capacity should depend upon the nature of the specific asset and its use.

banking operations using the capacity[9] or because banking operations become more efficient in their use of the capacity.[10]

The underlying reason for the acquisition or retention of excess capacity in any particular case is significant because, among other things, it can affect the analysis of whether the retention of the specific quantity of excess capacity is permissible in that particular case. For example, the rationale permitting retention of excess capacity acquired in reasonable anticipation of future growth might reasonably support fairly large amounts of initial excess capacity that will decline quickly. On the other hand, excess capacity that is acquired due to the "market availability" rationale will not necessarily decline over time and the likelihood that such excess will persist indefinitely may be considered in assessing the amount of permissible retained excess. Therefore, one cannot develop fixed rules on what specific quantity of excess capacity will meet the good faith standard in all retention cases.

Here, the Bank proposes to retain the excess capacity in the Printing Company in good faith for two reasons. First, the Bank has demonstrated a reasonable expectation that it will need the excess printing capacity for future expansion within the foreseeable future. The Bank has attested that it believes that, based upon projected growth, it will probably consume the entire printing capacity of the Company for banking purposes within five years. Second, the Bank also justifies retention of the excess capacity due to the necessities of market availability. The Bank credibly represents that it could not acquire de novo the needed printing capacity more economically, that the Company cannot be acquired without the excess, and that the excess cannot be divested without undue economic loss. Under either rationale, since the excess printing capacity will have been acquired and retained in good faith, it follows that the Bank may acquire the Printing Company and make full economic use of its excess capacity, including for non-banking functions.

I trust the foregoing is responsive to your inquiry. If you have any questions concerning this opinion, please contact Assistant Chief Counsel James Gillespie at (202) 874-5200.

Sincerely,

/s/

Julie L. Williams
Chief Counsel

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[9] See, e.g., Unpublished letter from William Glidden dated June 6, 1986.

[10] See, e.g., Unpublished letter from William Glidden dated July 11, 1989.