

the aggregate amount of net profit earned on all of its transactions over the past 10 years. If the net profits are insufficient, or if the Administrator does not exclude an amount sufficient to bring the borrower to or below the 15 percent level, the borrower would be required to reduce or restructure its portfolio (e.g., divest or shift some investments to excluded investments) in order to come within the 15 percent limit. If the borrower failed to do this within a timeframe set by RUS, the borrower would be in default of its RUS loan contract and/or RUS mortgage upon receiving written notice from RUS of the default.

*Section 1717.656 Investments, Loans, and Guarantees in Excess of 15 Percent of Total Utility Plant*

Proposed new § 1717.656 would establish policies and requirements for RUS approval of investments, loans and guarantees above 15 percent of total utility plant. The section would apply only to borrowers that do not qualify for an outright exemption from RUS approval under § 1717.655. In the case of distribution borrowers that do not qualify for an exemption, they would not be given approval to make controlled investments, loans and guarantees above the 15 percent level.

These borrowers currently represent less than 20 percent of all distribution borrowers, and all but one of them are below the 15 percent level at the present time. These borrowers would retain the latitude to make unlimited investments, loans and guarantees within those categories excluded from control under § 1717.654. Moreover, RUS believes that many of these borrowers could improve their economic and financial condition in order to qualify for the outright exemption under § 1717.655, if they want the additional latitude to make controlled investments, loans and guarantees above the 15 percent level.

In the case of power supply borrowers that do not qualify for an exemption under § 1717.655, RUS would consider requests to make controlled investments, loans and guarantees above the 15 percent level. To be eligible to submit a request, a power supply borrower would have to meet the following criteria:

- The borrower must be in compliance with all provisions of its RUS mortgage, RUS loan contract and any other agreement with RUS.
- The borrower cannot be in financial workout nor had its government debt restructured.
- The borrower must have equity of at least 5 percent of total assets.

- After approval of the request, the aggregate of the borrower's investments, loans and guarantees cannot exceed 20 percent of total utility plant. Beyond this level RUS believes that further investments, loans or guarantees outside of the "excluded categories" would present unacceptable risks in the case of borrowers that do not qualify for an exemption under § 1717.655.

If a power supply borrower meets the above criteria, its request would be considered on a case by case basis. In considering the request, the Administrator would take the following factors into consideration:

- The repayment of all loans secured by the RUS mortgage must continue to be assured and security must continue to be reasonably adequate even if the entire investment, loan or guaranteed amount were lost. This "total loss" approach would expedite review by RUS by eliminating the need to assess the probability of a loss occurring and its probable size. The effect of the loss of the entire investment, loan or guaranteed amount would be considered along with all other risks facing the borrower.

- In the case of an investment, the investment would have to be made in an entity separate from the borrower, such as a subsidiary, whereby the borrower would be protected from any liabilities incurred by the separate entity, unless the borrower is able to demonstrate that making the investment directly rather than through a separate entity would present no substantial risk beyond that of possibly losing part or all of the investment.

- The borrower must be economically and financially sound as indicated by its costs of operation, competitiveness, operating TIER and operating DSC, physical condition of the plant, ratio of equity to total assets, ratio of net utility plant to long-term debt, and other factors.

- Other factors affecting the security and repayment of government debt, as determined on a case by case basis.

This proposed new section 1717.656 would also clarify existing policy that if RUS approves an investment, loan or guarantee, such investment, loan or guarantee would continue to be included when calculating the borrower's ratio of aggregate investments, loans and guarantees to total utility plant. In other words, just because an investment has been approved by RUS doesn't mean it will not continue to be counted toward the borrower's total investments.

Proposed paragraph (d) of this section would deal with the situation where profits earned on investments increase

the aggregate amount of investment and could cause a borrower to be in technical violation of its loan contract or mortgage. The paragraph would make it clear that if a borrower exceeded the 15 percent limit as a result of net profits earned on the aggregate of its investments, loans and guarantees during the past 10 years, the borrower would not be in default of its loan contract or mortgage. Net profit would be calculated by taking the sum of all profits earned on all transactions during the past 10 years (including interest earned on cash accounts, loans, and similar transactions), and subtracting all losses experienced on all transactions during the same period.

Also, under proposed paragraph (d) RUS would be willing to consider a borrower's request to exclude up to the amount of net profit earned on the borrower's investments, loans and guarantees during the past 10 years. Such exclusion by RUS may or may not reduce the borrower's aggregate investments, loans and guarantees to or below the 15 percent limit. If it does not, the borrower would be required to restructure or reduce its portfolio to come within the 15 percent level. Failure to do so within a timeframe set by RUS would result, upon written notice from RUS, in a default by the borrower.

*Section 1717.657 Records, Reports and Audits*

Paragraphs (a), (b) and (c) of proposed § 1717.657 are the same substantively as existing § 1717.655. Proposed paragraph (a) is the same substantively as existing paragraph (a) of § 1717.655, and proposed paragraph (c) is the same substantively as existing paragraph (b). Proposed paragraph (b) would combine existing paragraphs (c) and (d).

Proposed paragraph (d) would be a new provision. It would clarify that RUS monitoring of borrower compliance with this rule will be based primarily on the annual financial and statistical reports submitted by borrowers (i.e., the RUS Forms 7 and 12), and the annual auditor's report on borrower operations. While RUS would ordinarily rely primarily on these annual reports, all borrowers would continue to be obligated to comply with this rule throughout the entire year. For example, if a borrower was below the 15 percent level at the end of the preceding year, it could not exceed the 15 percent level during the current year without prior approval from RUS, unless of course it was exempt from approval under proposed § 1717.655.