(1) The shipment consists of prunes sold for home use and not for resale, and

(2) Each container is stamped or marked with the handler's name and address and with the words "not for resale" in letters at least one-half inch in height.

(c) The term "U.S. No. 1" shall have the same meaning as when used in the United States Standards for Grades of Fresh Plums and Prunes (7 CFR 2851.1520–2851.1538); the term "purplish color" shall have the same meaning as when used in the Washington State Department of Agriculture Standards for Italian Prunes (April 29, 1978), and in the Oregon State Department of Agriculture Standards for Italian Prunes (October 5, 1977); the term "diameter" means the greatest dimension measured at right angles to a line from the stem to blossom end of the fruit; and, except as otherwise specified, all other terms shall have the same meaning as when used in the marketing agreement and order.

(Secs. 1–19, 48 Stat. 31, as amended; (7 U.S.C. 601–674))

Dated July 24, 1981, to become effective August 1, 1981.

D. S. Kuryloski,

Acting Director, Fruit and Vegetable Division, Agricultural Marketing Service.

[FR Doc. 81-22134 Filed 7-28-81; 8:45 am]

BILLING CODE 3410-02-M

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Adjustable Rate Mortgage Loans

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: This rule will allow Federal credit unions to make adjustable rate mortgage loans (ARMs). The National Credit Union Administration (NCUA) Board believes this rule will better enable Federal credit unions to provide mortgage loans to their members and will better enable Federal credit unions to match their assets (loans) earnings with their market sensitive liabilities and equity accounts (member shares and share certificate accounts) costs.

EFFECTIVE DATE: July 22, 1981.

ADDRESS: National Credit Union Administration, 1776 G Street, NW, Washington, DC 20456.

FOR FURTHER INFORMATION CONTACT: Thomas C. Buckman, Office of Examination and Insurance (Principal Draftsman), or John L. Culhane, Jr., Office of General Counsel, at the above address. Telephone numbers (202) 357–1065 (Mr. Buckman) or (202) 357–1030 (Mr. Culhane).

SUPPLEMENTARY INFORMATION: On December 1, 1980, the NCUA Board issued an Advance Notice of Proposed Rulemaking requesting comments on the use of adjustable rate mortgages by Federal credit unions (45 FR 79494 (1980)). The Advance Notice has provided the NCUA Board with the benefit of public comments concerning the scope and direction of this action.

In the Advance Notice of Proposed Rulemaking, NCUA established two goals in the development of an adjustable rate mortgage regulation: (1) balancing the interests of the member and the interests of Federal credit unions, and (2) developing a regulatory framework which would allow Federal credit unions to sell loans granted under a final regulation in the secondary market. The NCUA Board believes this final rule will accomplish the goals established.

On June 11, 1981, the NCUA Board invited public comment on a proposal to permit Federal credit unions to make adjustable rate mortgage loans (46 FR 31654 (1981)).

In general, the commentors supported the proposed rule and expressed the belief that it would better enable Federal credit unions to accomplish the following:

1. Expand mortgage loan service to members;

2. Balance market sensitive share and share certificate accounts with market sensitive loans; and

3. Facilitate the sale of adjustable rate mortgage (ARMs) loans in the secondary market.

Several of the commentors made suggestions in the interest of further simplifying the regulation. The NCUA Board concurs with the majority of the recommendations. Thus, the rule has been further simplified.

Amortization

The proposed rule would have placed three restrictions on loan amortization. First, an adjustable rate mortgage loan would have to have an amortization schedule sufficient to fully amortize the principal balance over the maturity of the loan. Second, if the principal balance is adjusted in response to a movement in the index, then the monthly payment would have to be adjusted at least every 5 years to a level sufficient to amortize the loan balance at the then existing rate over the remaining term of the loan. Third, an amortization schedule with a large final payment (i.e., a balloon payment) would have been prohibited.

The first requirement has been amended in order to clarify that monthly payments are required. The final rule states than an adjustable rate mortgage loan must be amortized by monthly installments sufficient to retire the loan at maturity.

The second requirement has been retained. One commentor recommended that NCUA eliminate the requirement in order to allow the monthly payment to be capped throughout the life of the loan. Although the regulation allows for payment caps up to 5 years, for safety and soundness reasons the NCUA Board believes it essential that at least every 5 years the monthly payment be adusted in order to prevent a huge final payment. Additionally, the NCUA Board believes that by giving a Federal credit union the option to extend loan maturity for a period of up to 40 years from the date the loan is made, sufficient flexibility has been granted.

The third requirement (prohibition of a large final payment) has been eliminated. As noted by one of the commentors, restrictions are placed on the size of the final payment since the monthly payment amount must be adjusted at least every 5 years to a level sufficient to amortize the principal balance over the remaining maturity of the loan. In addition, the Board notes that during the last 5 years of the loan the requirement could prevent a credit union from implementing increases in the index by adjusting the principal loan balance. This could preclude a credit union's participation in certain secondary market programs. Consequently, the requirement has been eliminated.

Adjustment Options

The proposed rule provided for adjustments in the interest rate to be implemented through changes in the monthly payment amount, through adjustment of the outstanding loan balance or through extension of the loan maturity. One of the commentors suggested that the final rule also permit Federal credit unions to use a combination of the above adjustment methods. The NCUA Board concurs and the final rule has been amended to permit combinations of the adjustment methods.

Some of the commentors suggested that the rule permit the capping of the maximum amount of any one adjustment either upward or downward to accommodate secondary market requirements. The NCUA Board concurs and has amended the rule to permit the capping of the maximum amount of any one adjustment. Additionally, the final

rule does not prohibit Federal credit unions from capping the maximum amount that the interest rate could increase over the duration of the loan.

Index

Some of the commentors suggested that the NCUA Board consider eliminating from the proposed 701.21–6B, Sections (e)(2), (e)(3), (e)(4), and (e)(6) since they merely reflect how the index will work under normal business procedures. Additionally, some commentors expressed the belief that the requirements were restrictive and could possibly cause problems with secondary market investors. The NCUA Board is persuaded to remove the requirements from the rule; however, it would like to emphasize the necessity of stating in the contract between the borrower and the Federal credit union exactly how a movement in the index will affect the borrower.

One commentor recommended that NCUA specifically require the use of an index base value as of the date the loan is closed. This commentor argued that using the value at closing would be consistent with the borrower's expectations. Further, the commentor noted that the index base value has a significance which may not be appreciated. For instance, if the index value at closing is one percentage point higher than the value 6 months earlier, selecting the earlier figure would mean that the interest rate on the loan would continually be one percentage point higher than would otherwise be the case. Moreover, credit shopping may be frustrated if different institutions are using different index base values since loans that are identical in all other respects will have very different costs over the long run.

The NCUA Board recognizes the seriousness of these concerns. However, at this time, the Board believes it important to provide credit unions with the maximum amount of flexibility so that they may participate in secondary market programs. In addition, the Board notes that the major credit union trade associations have indicated a willingness to cooperate with NCUA in the development of educational material which could be provided to prospective borrowers. This material can include a discussion of the significance of the index base value. Finally, NCUA believes that Federal credit unions, as member-owned and member-operated cooperatives, can be expected to select base index values in a reasonable manner so as to benefit their members, both borrowers and savers. Until such time as evidence of abuses in this area are brought to the attention of NCUA, the Board feels that it is unnecessary to regulate in this area, although NCUA will monitor the index selection of credit unions through its examination program and through its consumer complaint program to determine whether further regulation should be necessary.

Some of the commentors recommended that Federal credit unions be permitted to use their own cost of funds as an index. The NCUA Board has seriously considered this recommendation since such an index would move in direct correlation with a credit union's cost of funds. The NCUA Board believes that the disadvantages to permitting Federal credit unions to use their own cost of funds as an index overshadow the aforementioned benefit. Since mortgage loans are normally for long periods of time and for large amounts of money, the safety and soundness of a Federal credit union could possibly be seriously threatened if, at a later date, it was found that the contracts between the members and the credit union were unclear to the members with regard to the elements used to establish the index. Additionally, an index controlled by a Federal credit union could be subject to the challenge that the credit union manipulated the index for its own benefit. Thus, due to the potential risks, the large amounts of money involved, and the extended periods of time which mortgage loans remain outstanding, the change recommended was not made.

Some of the commentors suggested that NCUA develop an index which represents the interest rate charged by credit unions for mortgage loans similar to that of the Federal Home Loan Bank Board. The NCUA Board will consider developing an index, as recommended, in the future if it is demonstrated that the other indices are not adequate.

The Advance Notice of Proposed Rulemaking (45 FR 79494 (1980)) listed four possible indices. They are listed again below to assist Federal credit union management in choosing an index. It should be noted that the final rule does not limit the choice to just these indices. The indices are:

1. The average contract interest rate charged by all lenders on mortgage loans for previously occupied homes as published by the Federal Home Loan Bank Board in its *Journal*.

2. The average monthly gross yield to the Federal National Mortgage Association on accepted bids in weekly or biweekly auctions for 4-month commitments to purchase FHA insured or VA guaranteed home mortgages as published in the *Federal Reserve Bulletin*.

3. The average monthly yield on the United States Treasury securities adjusted to a constant maturity of 3 years based on daily closing bid prices as published in the *Federal Reserve Bulletin*.

4. The average monthly yield on the United States Treasury securities adjusted to a constant maturity of 5 years based on daily closing bid prices as published in the *Federal Reserve Bulletin*.

The commentors recommended that some exceptions be granted to the requirement that any downward movement in the index result in a decrease in the interest rate in order to facilitate the sale of ARMs in the secondary market and to provide for operational efficiencies. The NCUA Board believes the recommendations have merit and, therefore, provided exceptions to the mandatory decrease in the interest rate in the final rule.

Costs or Fees

Some of the commentors suggested the removal of the restrictions in the proposed regulation which prohibit charging borrowers for any costs or fees in connection with regularly scheduled adjustments. The NCUA Board believes the costs in instituting regularly scheduled changes should be minimal and these prohibitions provide a degree of additional protection to the borrower. Therefore, the final rule contains the same language as the proposed rule.

Notice to Borrowers of Payment Adjustment

Several of the commentors suggested that the extensive notice requirements either be substantially reduced or completely eliminated. The commentors stated that the notice requirements were operationally cumbersome. They cited that while the regulation permitted monthly adjustments of the interest rate, it would be very difficult to institute such changes since the proposed regulation required that the borrower be notified of what change occurred in the index at least 30 days prior to instituting the change. The commentors also cited other operational problems and additional costs that Federal credit unions would need to incur as a result of the notice requirement.

The NCUA Board believes that in the normal course of business Federal credit unions will provide for some notification to borrowers. Therefore, in view of the potential operational problems cited by the commentors, the NCUA Board is persuaded to eliminate the notification requirement.

Disclosure

The proposed rule posed two alternative disclosures. Under the first alternative, disclosures would be made in accordance with the Truth in Lending Act and Regulation Z. (Under Regulation Z, in connection with the variable rate feature of a loan, a lender must disclose the circumstances under which the rate may increase, any limitations of the increase, the effect of any increase, and an example of the payment terms that would result from an increase.)

Under the second alternative, a Federal credit union would be required to make the disclosures mandated by the Truth in Lending Act and Regulation Z at the time of or within 3 days of application and, in addition, would be required to disclose the index to be used, how often an increase might take place, and how the increase will be calculated. All of these disclosures would have to be made in commonly understood language. These disclosures would have to be made at or within 3 days of the time of application for shopping purposes.

Some of the commentors representing consumer groups recommended that the NCUA Board adopt a disclosure which would require more information to be disclosed than required by either of the proposed alternatives.

One of the commentors stated the belief that the key to consumer protection in adjustable rate mortgage transactions lies in member education, not in more lengthy disclosure statements. The NCUA Board is in agreement that the key to consumer protection is member education. The Board encourages Federal credit unions to develop formal educational programs to inform members on an ongoing basis of the mechanics of an adjustable rate mortgage in order that the members can make an informed decision about a mortgage loan.

Overwhelmingly, the commentors suggested that the NCUA Board adopt the first alternative. The commentors generally supported the position by stating that they believed that the disclosure requirements of Regulation Z were adequate, additional disclosures will be counterproductive and cause confusion among credit unions pertaining to compliance, and that additional disclosures would be contrary to Congressional intent.

Also, it appears from the Federal Reserve Board proposed official staff commentary (46 FR 28595) on the revised Regulation Z that the information required by the second alternative is already substantially covered by the requirements of Regulation Z.

As to disclosure content, NCUA believes that the Regulation Z requirements in conjunction with the proposed official staff interpretation, provide meaningful consumer protection. Therefore, the disclosures for adjustable rate mortgages should be made in accordance with Regulation Z. The Regulation Z disclosure requirements are not specifically cited in the final rule since Federal credit unions are already bound by the requirements of Regulation Z.

Federal credit unions may use the model clauses and forms provided in the revised Regulation Z. If Federal credit unions design their own forms, such forms should be in commonly understood language. NCUA will be monitoring through its examination program the language in forms designed by Federal credit unions. If abuses are noted, regulatory measures will be considered by the NCUA Board.

Opposing View

Opposing views were received from consumer associations which expressed the belief that government regulations rather than the market place should dictate the conditions under which ARMS develop. The NCUA Board believes that by developing a regulation in which Federal credit unions have the flexibility to actively compete in the market place that the credit union consumer will ultimately benefit. As previously stated, the NCUA Board believes the key to consumer protection is member education not government regulation. NCUA is pleased to note that the major trade associations representing credit unions have indicated a willingness to work with NCUA in carrying out member education.

Procedures for Regulatory Development

This final rule is effective immediately because the rule relieves regulatory restrictions and because delay may not be in the public interest in that it could hamper the ability of Federal credit unions to manage their loan portfolios in a safe and sound manner. Additionally, delay could hamper the ability of Federal credit unions to offer adjustable rate mortgage loans to their members on a more equal competitive footing with other federally chartered institutions (5 U.S.C. 553(d) (1) and (3)).

The NCUA Board certifies that the final rule will not have a significant economic impact on a substantial number of small Federal credit unions (Federal credit unions with less than $1,000,000 in assets). The NCUA Board believes that only a few credit unions under $1,000,000 in assets are making long-term real estate loans. Therefore, a substantial number of small Federal credit unions would not be affected and a final regulatory flexibility analysis is not required (5 U.S.C. 605(b)).

Furthermore, since the final rule will reduce burdens where delay would cause unnecessary harm, the NCUA Board finds that full consideration of all the policies of the Regulatory Simplification Act is impracticable. However, the NCUA Board has considered most of these policies as set forth in the preamble above.

By the National Credit Union Administration Board, this 22d day of July 1981.

Beatrix D. Fields,

Acting Secretary of the NCUA Board.

(12 U.S.C. 1757, 1766(a), 1789(a)(11))

Accordingly, 12 CFR Part 701 is amended by adding a new § 701.21–6B to read as follows:

§ 701.21–6B Adjustable rate mortgage loans.

(a) Definition.

(1) An adjustable rate mortgage loan is a mortgage loan which permits the periodic adjustment of the rate of interest on the loan in response to the movement of an index which was agreed upon in advance by the borrower and the Federal credit union.

(b) Authorization.

(1) Federal credit unions are permitted to make adjustable rate mortgage loans to members. Such loans must be secured by first liens on residential real property and must have initial maturities in excess of 12 years and not exceeding 30 years. Loans which are made under the provisions of this rule shall also comply with all the provisions of Section 701.21–6 of the NCUA Rules and Regulations except for the following:

(i) The provisions of § 701.21–6(b)(2) (which require substantially equal monthly payments);

(ii) The provisions of § 701.21–6(b)(4) (which limit the aggregate dollar amount of fixed rate mortgage loans to 25 per centum of the credit union's assets); and

(iii) The provisions of 701.21–6(b)(7) (which require the use of the FNMA/FHLMC Uniform Instruments).

(2) This rule is promulgated pursuant to the plenary and exclusive authority of the NCUA Board as set forth in Sections 107(5)(A)(i), 107(5)(A)(ix), and 107(13) of the Federal Credit Union Act to regulate, respectively, the real estate loans granted by Federal credit unions, the amortization of loans granted by Federal credit unions, and the sale of loans

granted by Federal credit unions. This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's ability or right to make adjustable rate mortgage loans or to directly or indirectly restrict such ability or right.

(c) Amortization.

(1) Adjustable rate mortgage loans shall be amortized by monthly installments sufficient to retire the loan at maturity. If the principal balance of the loan is adjusted in response to a movement in the index, the amount of the monthly payment shall be adjusted at least every 5 years to a level sufficient to amortize the loan balance at the then existing interest rate over the remaining term of the loan.

(d) Adjustment Options.

(1) Adjustments to the interest rate may be implemented through changes in the monthly payment amount, through adjustment to the outstanding principal loan balance, through extension of the loan maturity or by a combination of these adjustments.

(2) Adjustments shall not cause the maturity to exceed 40 years.

(3) Adjustments may be made as frequently as monthly.

(4) The maximum amount of any one adjustment may be capped.

(e) Index.

(1) The adjustment in the interest rate shall correspond with the movement of an index or an average of an index agreed upon in advance, subject to such rate adjustment limitations, if any, as a Federal credit union may provide. The index must be beyond the control of the Federal credit union and readily verifiable by the borrower.

(2) Where the index or an average of an index has moved downward, a decrease in the interest rate is mandatory except to the extent that:

(i) The decrease is offset by previously permitted interest rate increases not taken;

(ii) The decrease exceeds a cap limitation;

(iii) The decrease in the interest rate is less than one-eighth of 1 percent; or

(iv) The decrease would reduce the interest rate below a minimum rate agreed upon in advance by the borrower and the Federal credit union.

(f) Costs or Fees.

(1) The borrower shall not be charged any costs or fees in connection with regularly scheduled adjustments to the interest rate, the monthly payment, the outstanding principal loan balance, or the loan maturity.

[FR Doc. 81-22060 Filed 7-28-81; 8:45 am]

BILLING CODE 7535-01-M

12 CFR Part 701

Deregulation of Lending Policies, Amortization and Payment of Loans, and Lines of Credit

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: In accordance with its established policy of reviewing its regulations at regular intervals, the National Credit Union Administration (NCUA) reviewed its regulations covering lending policies, amortization of loans and lines of credit. As a result of this review, the NCUA Board has approved these final rules which reduce the regulatory burden on Federal credit unions, provide greater flexibility to the boards of directors of Federal credit unions in establishing lending policies, permit variable rate consumer loans and permit broad authority to Federal credit unions in offering lines of credit.

EFFECTIVE DATE: July 22, 1981.

ADDRESS: National Credit Union Administration, 1776 G Street, N.W., Washington, D.C. 20456.

FOR FURTHER INFORMATION CONTACT: Barbara A. Burrows, Attorney-Advisor, Office of General Counsel at the above address. Telephone: (202) 357-1030.

SUPPLEMENTARY INFORMATION: On June 11, 1981, the NCUA Board issued for public comment proposed rules regarding lending policies (12 CFR 701.21-1), amortization and payments of loans (12 CFR 701.21-2), and lines of credit (12 CFR 701.21-3). 46 FR 31651 (June 17, 1981). Of the 25 commenters, 5 were credit union leagues, 15 were Federal credit unions, 2 were consumer associations, 1 was a credit union service corporation specializing in data processing services, 1 was an attorney representing Federal credit unions, and 1 was a representative of a housing task force.

Lending Policies 701.21-1

Section by Section Analysis of Final Rule

701.21-1(a). Subparagraph (a) of the final rule is the same as the proposed rule. It sets forth the general rule that the board of directors of a federal credit union must establish written lending policies consistent with cooperative principles. All of the commenters who addressed this provision generally concurred with its spirit and breadth, including the requirement that lending policies be in writing.

The rule clarifies that although the board is free to set its own policies, it must do so within the limitations of applicable law, (such as the Federal Credit Union Act and the Consumer Credit Protection Act), within the limitations of applicable regulations (such as Regulation Z (Truth in Lending) and Regulation B (Non-Discrimination)) and within the limitations of applicable bylaws (such as Article XII (Loans and lines of credit to members)). Although one commenter suggested that the Board delete references to applicable law, regulations and bylaws, the Board believes it is extremely important to remind credit unions that their freedom to set lending policies is not unrestricted. Therefore, these general references are retained in the rule.

Further, the final rule continues the existing requirement that lending policies be in writing. The NCUA Board continues to view this as essential not only to assure that the board of directors meets its responsibilities under the Federal Credit Union Act, but also to ensure that credit union members are afforded their rights under consumer protection laws.

701.21-1(b). This subparagraph is designated in the current rule as 701.21-1(d). Although it is retained without change, it is redesignated as 701.21-1(b).

701.21-1(c). The final rule requires a borrower's loan file to contain a loan application evidencing the financial data on which the decision to grant the loan was made. The final rule condenses some existing requirements of 701.21-1(e) and (f) and removes the specific eight recordkeeping requirements of the existing rule because they duplicate the requirements of Article IX, sections 6 and 8 of the Federal Credit Union Bylaws. (These bylaw sections promote sound credit granting decisions by requiring a Federal credit union to inquire into the applicant's financial condition and to determine the value of security.) the proposed rule would have further required that the application (1) reflect the borrower's financial conditon and the financial condition of the borrower's sureties; (2) evidence the ability to repay of the borrower and the borrower's sureties; and (3) support the approving officer's decision to extend credit. One commenter quite appropriately pointed out that because Article IX of the bylaws generally requires the same type of information, this provision could be considerably shorter but still be sufficiently effective. The Board agrees. Therefore, in its final rule, the Board has deleted the three subparagraphs that require specific information to be on file and in their place has substituted the phrase "supports the decision to extend credit."

Unlike the former rule, the final rule allows a Federal credit union to use an abbreviated loan application for a share secured loan. The rule eliminates the need for a credit union to collect and retain detailed information for a share secured loan, thereby reducing costs in employee time and recordkeeping. As noted by one commenter, in the case of a fully share secured loan, a signed security agreement would be sufficient to satisfy this requirement of 701.21–1(c).

Discussion of changes and deletions from the former rule

§ *701.21–1(a).* The former rule contains definitions of "security," "unsecured loan limit," and "loan file." The NCUA Board proposed to delete these definitions because they simply restate the trade meaning of these terms. All commenters who addressed this proposed action concurred with it. Accordingly, the Board's final rule does not include the definitions. The Board notes that a further discussion and guidance about the nature of security and secured loans may be found in the NCUA *Credit Manual* which contains an entire chapter on security.

701.21–1(c). The former rule required a Federal credit union to notify its members when it increases its loan interest rates above the traditional 12%. The NCUA Board proposed to delete all of this subparagraph because the requirement is now obsolete. All commenters who addressed this issue agreed. The Board has eliminated this requirement in the final rule.

Amortization and Payment of Loans to Members 701.21–2

General Purpose

Because the former requirements of § 701.21–2 unnecessarily limited the ability of the board of directors in the management of its loan portfolio, the NCUA Board proposed to revise that section. Commenters generally agreed with the NCUA proposal to give the board of directors significantly greater flexibility in establishing its amortization and loan repayment policies.

Discussion of Proposed and Final 701.21–2

The NCUA Board offered for comment two alternative proposals. Both proposals would provide the board of directors a great deal of flexibility in establishing amortization and loan payment policies, but would require the board to establish these policies after considering the needs of the borrowers, the amounts and durations of the loans, the interests of the members and such other factors the board deems relevant. In addition, both alternatives would require that accrued interest to date be paid with each payment of principal. The second alternative imposed additional restrictions in that it would (1) impose a maximum maturity of 36 months on a single payment loan and (2) continue the existing requirement that interest accrued to date must be paid at least annually, except that the board of directors may set interest payments for crop loans as it deems appropriate.

Nine of the eleven commenters who expressed a clear preference chose the less restrictive alternative #1, noting that it is more consistent with the spirit of deregulation and would provide greater flexibility to the board of directors. It was suggested, however, that even the less restrictive alternative #1, requiring that interest accrued to date must accompany each principal payment, reflects sound business practice that a properly managed credit union would utilize in the absence of a regulatory mandate. The Board agrees that the restrictions regarding collection of interest of both alternatives reflect sound business practice and, therefore, the final rule contains neither of the alternatives. By taking this action, the Board eliminates the existing regulatory requirements that an interest payment must accompany each principal payment and that interest must be collected not less frequently than annually.

The Board notes that this action is consistent with the other Federal financial regulatory agencies which appear to impose no such regulatory restrictions. However, the Board also notes that it takes this action with the expectation that FCU's will operate according to established sound business methods. Accordingly, the Administration, through its examination program, will monitor FCU's loan amortization practices, especially their balloon note and irregular payment transactions.

Although the Board has eliminated the proposed subparagraph (b), it has substituted a new subparagraph (b). The new provision clearly states the Board's intention to preempt state laws that purport to address a Federal credit union's ability or right to make variable rate consumer loans or to restrict this right either directly or indirectly.

Section by Section Analysis of the Final Rule

701.21–2(a) General Rule. Final 701.21–2 removes existing requirements that the Board believes unnecessarily limit the ability of the board of directors in managing its loan portfolio.

Balloon Payments. The final rule will allow a credit union to use final large payments (formerly called balloon payments under Regulation Z. Current: 12 CFR 226.8(b)(3); Simplified: 46 FR 20848 (1981) (to be codified in 12 CFR 226.18(g)). Because the Board recognized possible problems resulting from the use of balloon payments (such as a threat to solvency if borrowers default simultaneously) the Board solicited comments on their advantages and disadvantages and whether limitations should be placed on them.

With one exception, all of the commenters addressing balloon payments noted the advantages of FCU's having unrestricted ability to use them. The majority of the commenters either expressly or impliedly indicated that it is the management responsibility of the board of directors, not the regulatory responsibility of NCUA, to assess the risk of any individual balloon note or group of balloon notes. However, in accord with the suggestions of several commenters, the NCUA Board emphasizes to FCUs the importance of properly managing their loan portfolios, reminds them that balloon loans are likely to be unsuitable for typical consumer lending, and cautions them to seriously consider the relationship of balloon notes to liquidity, earnings, depreciated collateral and default before underwriting notes of this type.

Liquidity: Balloon note assets generally should be balanced by liabilities whose likelihood of withdrawal is remote, such as IRA and Keogh accounts, or other long term liabilities. A credit union that underwrites excessive balloon notes balanced by shorter term liabilities such as regular share accounts severely threatens its liquidity. Also, an FCU with excessive balloon notes increases the possibility of impairing its cash flow, which, if severe enough, could cause the credit union to be unable to meet daily cash demands.

Earnings: Current interest rates, propelled by high inflation, have soared to almost unparalleled heights, leading to particular difficulties for lenders holding fixed, lower rate long term loans. As the cost of funds to these lenders changed with the volatile economy, their earnings plummeted. Excessive use of balloon notes could produce a similar earnings decline to an FCU whose cost of funds increases while its income is fixed to balloon notes at lower levels.

Collateral: With a balloon note, the underlying collateral may depreciate while the principal balance remains the same. Therefore, while the value of the

security at the outset may be sufficient to fully secure the loan, the depreciated collateral may be insufficient to cover the remaining balance of a delinquent balloon payment. FCU's are cautioned, therefore, to undertake regular reviews of the sufficiency of collateral supporting such loans. NCUA will monitor the use of balloon notes through its regular examination program.

Default: The potential for default may be greater on a balloon note than on a note requiring substantially equal payments because generally there is less contact with the borrower and therefore the knowledge of possible default surfaces much later. For this reason, the NCUA Board encourages each FCU to exercise extraordinary care at the time the loan is granted to assure that the borrower will have adequate resources to service the balloon note at maturity. Because mismanagement of balloon notes can threaten the financial stability of a Federal credit union, NCUA will monitor the use of balloon and irregular payment notes through its examination program. The NCUA Board encourages each FCU to avoid the following practices which may, under normal circumstances, adversely affect its financial stability:

(1) Refinancing or extending a note to avoid reporting it as delinquent. Each FCU should be satisfied, before extending or refinancing the loan, that the borrower has or will have the ability to repay at maturity. Balloon payment notes and irregular payment notes require very close monitoring. For this reason and for reporting purposes FCU's are encouraged to consider such notes as past due immediately after a scheduled interest or principal payment is unpaid.

(2) Funding a substantial portion of balloon and irregular payment loans with liabilities of unmatched terms.

(3) Funding a substantial portion of fixed rate balloon and irregular payment loans with market sensitive liabilities.

NCUA cautions FCUs that if these or similar practices threaten a credit union's financial stability, NCUA stands ready to issue an IRPs regarding such practices and NCUA also will use its enforcement powers to halt and prevent such practices.

Variable Rate Consumer Loans

In addition to allowing balloon notes, the broad new authority under the general rule will also allow a credit union to grant a variety of "variable rate" consumer loans. NCUA's former regulation required that a member loan " * * * shall be paid by substantially equal payments * * *," which precluded changes in the regular payment amount as a means of implementing adjustments in the loan rate. Therefore, although a credit union could grant a "variable rate" loan under the former regulation, its only means of adjusting the loan to the new rate was to extend the loan maturity. (The maturity for consumer loans, including all extensions, is limited to 12 years by § 107 of the Federal Credit Union Act. Mobile home loans and home improvement loans may have a maturity of 15 years.)

With respect to variable rate consumer loans, NCUA invited comment on whether NCUA should restrict adjustment to the outstanding principal loan balance, indexes, and the frequency and amount of an adjustment.

Adjustment to the outstanding principal loan balance. When variable rate loans are adjusted through addition of unpaid interest to the principal balance, the result may be that large final payments are required which are potentially risky and dangerous to liquidity, earnings, depreciated collateral and default in the same ways that balloon notes are potentially dangerous in these areas. Of the four commenters who specifically addressed this issue, three favored no restrictions. The opposing view suggested that adjustment to the outstanding principal loan balance should not be allowed under any circumstances. The NCUA Board believes that Federal credit unions should have maximum flexibility to design loans suited to the needs of their members. Therefore, while individual credit unions may place limits on this activity, no such limits will be required by regulation.

Indexes. All commenters who addressed this issue favored no restrictions on indexing. Several, however, asked NCUA for general guidance.

While the NCUA Board agrees that an FCU should be free to choose its own index, NCUA encourages the credit union to use a simple index that is (1) easily ascertainable, (2) beyond the control of the credit union and (3) readily verifiable by the borrower. The Board cautions each Federal credit union that general contract law holds that a contract may be void if key terms are so uncertain or so indefinite as to be undeterminable. Such uncertainty or indefiniteness may be found under state contract law if the variable rate loan index reserves to the FCU excessive discretion. Thus, an FCU may be risking a lawsuit if it retains the right, with regard to a single borrower, to adjust the rate without any index whatsoever or if the FCU uses the cost of its funds as the index. An FCU can protect itself from such a lawsuit if the power to vary the interest rate is specifically limited by a marketplace index and requires periodic redetermination, in good faith and in the ordinary course of business, of the price to be charged to all of the FCU's borrowers that are similarly situated. *Constitution Bank and Trust Co.* v. *Robinson*, 425 A.2d 1268 (Conn. 1979).

An FCU may choose to adjust the loan upward or downward if the index rises, or falls. The Board encourages each FCU, however, to consistently adjust both types of index fluctuations, downward as well as upward.

Frequency and amount of adjustments. All seven commenters who addressed this issue urged NCUA to allow each FCU to forge its own lending policies regarding the frequency and amount of adjustments in variable rate loans. The NCUA Board agrees for reasons succinctly stated by one commenter: "The local environment, the spectrum of a particular credit union's other services, the sophistication of data processing technology, and the cost of doing business are all factors which credit unions will take into account in passing on specific lending programs." NCUA agrees that the individual credit union is best prepared to make loan adjustment decisions, in light of its individual circumstances.

Disclosures. The Board proposed two options regarding disclosures. The first option paralleled the existing requirements of Regulation Z and the Truth in Lending Act, 46 FR 20903 to be codified at 12 CFR 226.18(f). The second option required a Federal credit union to comply, at the time of application, with the disclosure requirements of the new Regulation Z and also required the FCU to disclose the index to be used, how often an increase might take place, and how the increase would be calculated. All of these disclosures would be in commonly understood language.

Three commenters favored option #2. These commenters viewed the Regulation Z requirements as inadequate. They therefore urged NCUA to require more detailed disclosures with more meaningful examples.

However, the overwhelming majority of commenters favored option #1, stating that the Regulation Z disclosures are sufficient and any additional disclosures would unnecessarily burden a credit union. Several commenters pointed out that option #2, which would require disclosure at the time of application, would be operationally impractical in those cases where loan applications are received by telephone. (Some FCU's, it was noted, receive a substantial portion of their loan

applications by phone.) The NCUA Board agrees.

It appears from the Federal Reserve Board proposed official commentary (46 FR 28595) on revised Regulation Z that the information required by proposed option #2 is already substantially covered by the requirements of Regulation Z. For example, under Regulation Z, (as clarified by the official staff commentary) in connection with the variable rate feature of a loan, the lender must disclose the following information in readily understandable language and usable form:

(1) *Circumstances under which rate may increase.* The "circumstances" would include identification of any index to which the rate is tied, as well as any conditions or events on which the increase is contingent.

(2) *Any limitations on the increase.* The "limitations" refer to any maximum imposed on the amount of an increase at any time, as well as any maximum on the total increase over the life of the transaction.

(3) *The effect of an increase.* The "effect" refers to an increase in the number or amounts of payments or an increase in the final payment.

(4) *An example of the payment terms that would result from an increase.* The creditor may provide a standard example that represents the general type of credit offered or an example that directly reflects the terms and conditions of the particular transaction.

The Board believes that these Regulation Z disclosures, as explained by the commentary, substantially parallel the disclosures required by option #2. For this reason, option #1 of the proposed regulation is adopted for consumer loans.

Federal credit unions may use the model clauses and forms provided in Appendix H of the revised Regulation Z. If Federal credit unions design their own forms, such forms should be in commonly understood language.

Member Education

The NCUA Board strongly encourages each Federal credit union that offers variable rate consumer loans to establish a member education program for prospective applicants for such loans to help them understand how loans of this type work under varying conditions, including "worst case" situations. The program would be voluntary and in addition to any disclosure requirements.

§ 701.21–2(b)—Preemption.

The Board has added a new subparagraph (b) to make it clear that NCUA intends to preempt any State law purporting to address the subject of a Federal credit union's authority to grant variable rate consumer loans. NCUA also intends to preempt, for example, any State law purporting to restrict interest rate increases associated with such loans.

Lines of Credit to Members § 701.21–3

Discussion of Former Rule and Final Changes

Sections 701.21–3(a) (1) and (2) define the terms "line of credit" and "agreement." The NCUA Board believes these terms are defined appropriately in the former regulation and retains them in the final rule.

Contents of the Line of Credit Agreement

Section 701.21–3(b) of the existing regulation sets forth the minimum provisions required in a line of credit agreement. The final rule eliminates this entire subparagraph because its requirements are either requirements of the Federal Credit Union Act (in which case the regulation is duplicative) or dictated by sound business practice (in which case the provisions normally would be included in any line of credit agreement). The commenters addressing this change overwhelmingly concurred.

Termination of the Agreement

The NCUA Board believes that the former requirements as to conditions under which a credit union could terminate the agreement reflect obvious sound business practice. While the Board's final rule eliminates them as a regulatory requirement, the Board encourages the writing of line of credit agreements that will set forth the specific conditions under which the agreement may be terminated by the credit union. (The borrower, of course, may terminate the agreement for any reason at any time, but must repay the outstanding obligation existing at the time of termination.)

In its proposal, the Board retained the existing requirement that a credit union notify the member in writing of the termination of a line of credit. The Board requested comments as to whether it should require that the notice be sent within a specific time period after termination. Four of the nine commenters who addressed this issue correctly pointed out that a credit union is already required to send such a notice under Regulation B (12 CFR 202.9) which implements the Equal Credit Opportunity Act. This Regulation B notice, however, would be required only in cases of consumer credit, not commercial or agricultural credit, and only where the termination affects less than a substantial portion of the line of credit borrowers. Therefore, if a credit union terminated all lines of credit simultaneously, Regulation B would not require the credit union to notify affected borrowers.

After carefully considering the Regulation B requirements, the Board has decided to eliminate the notice of termination requirement from the final rule. The Board has substituted a new subparagraph (c) to make it clear that the only notice required is the Regulation B notice and that NCUA preempts any state law that purports to regulate termination notices regarding lines of credit. While a credit union is not now required to send notice in all cases, the NCUA Board believes that Regulation B would require notice in the overwhelming majority of cases encountered by FCUs. Even in those cases where notice would not be required, the Board believes that a credit union possesses adequate independent incentive to notify its member of the termination.

36-Month Review, Reapplication, Disbursements Exceeding a Borrower's Credit Limit, Review of Liquidity Status

The Board proposed to delete from the existing rule subparagraphs 701.21–3(d) [36-month review], 701.21–3(e) [Reapplication], 701.21–3(f) [Disbursements exceeding a borrower's credit limit], and 701.21–3(g) [Review of liquidity status]. All commenters who addressed this action concurred and the sections have been deleted.

Regulatory Procedures

Regulatory Flexibility Act

The NCUA Board hereby certifies that the final rules will not have a significant economic impact on a substantial number of small credit unions because the rules would increase their management flexibility, increase their competitive positions and reduce their paperwork burdens. Therefore, a final flexibility analysis is not required, 5 U.S.C. 605(b).

Effective Date

These rules will be effective in less than 30 days because they relieve regulatory restrictions. 5 U.S.C. 553(d)(1).

By the National Credit Union Administration Board this 22nd day of July 1981.

Dated: July 22, 1981.

Beatrix Fields,

Acting Secretary of the NCUA Board.

(12 U.S.C. 1757, 1761(b)(c) and 1766(a))

Accordingly, 12 CFR 701.21–1, 701.21–2, 701.21–3 are revised as set forth below.

§ 701.21–1 Lending Policies.

(a) General Rule: Within the limitations prescribed by applicable law, regulations and bylaws, the board of directors shall establish written lending policies consistent with cooperative principles.

(b) Interest rates charged on loans (including line of credit balances) may vary according to written classifications established by the board of directors consistent with cooperative principles and existing laws and regulations.

(c) Subject to limitations established by the board of directors, the credit committee or loan officer shall assure that a credit application for each borrower is on file which supports the decision to extend credit.

§ 701.21–2 Amortization and payment of loans to members.

(a) General rule: Loans shall be paid or amortized in accordance with written policies prescribed by the board of directors after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interests of the members and such other factors as the board deems relevant.

(b) This rule is promulgated pursuant to the exclusive authority of the NCUA Board to regulate consumer lending and loan amortization as set forth in sections 107(5), 107(5)(A)(ii), 107(5)(A)(iii) and 107(5)(A)(ix) of the Federal Credit Union Act, 12 U.S.C. 1757(5), (5)(A)(ii), (5)(A)(iii), and (5)(A)(ix). This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's ability or right to make variable rate consumer loans or to directly or indirectly restrict such ability or right.

§ 701.21–3 Lines of credit to members.

(a) For the purposes of this section:

(1) "Line of credit" means a fixed amount which may be drawn upon by a member from time to time and which may be replenished by payment on amounts previously drawn.

(2) "Agreement" means the written document signed by the borrower to establish the terms and conditions of a line of credit.

(b) Each line of credit must be evidenced by an agreement.

(c)(1) Notice of termination of a line of credit shall comply with the Equal Credit Opportunity Act and Regulation B.

(2) This subparagraph is promulgated pursuant to the exclusive authority of the NCUA Board to regulate lines of credit as set forth in section 107(5)(B) of the Federal Credit Union Act. 12 U.S.C. 1757(B). This exercise of the Board's authority preempts any state law purporting to address the subject of a Federal credit union's responsibility to notify a borrower regarding termination of a line of credit.

[FR Doc. 81–22058 Filed 7–28–81; 8:45 am]
BILLING CODE 7535–01–M

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12 CFR Part 701

Fixed Rate Mortgage Loans

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: As part of its ongoing program updating, clarifying and simplifying existing regulations, the National Credit Union Administration (NCUA) has reviewed its regulation governing long term mortgage loans. As a result, NCUA is amending its regulation so that adjustable rate mortgage loans will not be included in the limit on the aggregate dollar amount of long term real estate loans that a Federal credit union may have outstanding. (A Federal credit union may have up to 25 percent of its assets in long term real estate loans.) NCUA is also amending the regulation to clarify that, regardless of state law, a Federal credit union is required to have a due on sale clause in its loan instruments. And further, regardless of state law, a credit union may exercise that clause unless the person to whom property is sold or transferred and the Federal credit union reach written agreement that the credit of such person is satisfactory and that the interest payable to the credit union shall be at such rate as the credit union shall request.

EFFECTIVE DATE: July 22, 1981.

FOR FURTHER INFORMATION CONTACT: John L. Culhane, Jr., Senior Attorney, Office of General Counsel, National Credit Union Administration, 1776 G Street, NW., Washington, D.C. 20456. Telephone number: (202) 357–1030.

SUPPLEMENTARY INFORMATION:

Summary of Comments

1. Background

As part of its ongoing program of updating, clarifying and simplifying existing regulations, NCUA conducted a review of Section 701.21–6, its regulation governing long term real estate loans. However, because the regulation had been reviewed on several occasions since it was adopted in 1978, comments were solicited on only two changes in the regulation. NCUA requested comments (1) on whether or not to increase the aggregate dollar amount of long term real estate loans that a Federal credit union may have outstanding and (2) on regulatory language that would clarify NCUA's position on the use of a due on sale clause by a Federal credit union. 46 FR 31654 (1981).

2. Percentage of Assets Limitation

In granting Federal credit unions the power to make long term real estate loans Congress recommended that NCUA ensure that Federal credit unions provide this service without adversely affecting their primary function of providing low cost consumer loans to their members. NCUA was given the discretion to impose maximums on the percentage of a credit union's portfolio that could be allocated for long term real estate loans and was also given the discretion to determine whether this percentage should vary according to the asset size of the credit union. *See* H.R. Rep. No. 23, 95th Cong., 1st Sess. 9 (1977).

When initially promulgating its regulation, NCUA determined to limit the aggregate dollar amount of real estate loans outstanding to 25 percent of the credit union's assets. 43 FR 14925 (1978). That percentage has remained unchanged to date. The regulation does, however, provide for a relaxation of this limit with the prior written consent of the Administration.

In reviewing the regulation, the Board requested comments as to whether this limit should be increased, in order to provide greater flexibility to Federal credit unions, in light of the proposed regulations which would permit Federal credit unions to make adjustable rate mortgage loans. The Board observed that loans that are sold are not included in the percentage limitation (and only the interest that is retained is included when part of a loan is sold). However, until such time as an extensive secondary market develops for adjustable rate mortgage loans, Federal credit unions offering such loans may of necessity have to retain a significant number of them in their loan portfolios. Consequently, a change may be advisable to enable Federal credit unions offering adjustable rate mortgage loans to their members to better compete with other lenders by remaining in the mortgage market longer than would otherwise be the case.

The majority of the commenters felt that a change would be appropriate to accommodate adjustable rate

mortgages; however, the commenters differed as to whether a change should be made with respect to fixed rate mortgage loans, and if one should be made, exactly what form it should take. Most commenters recommended that, at a maximum, an exception should be made for adjustable rate mortgage loans. Other commenters recommended retaining the limitation for fixed rate mortgage loans. Other commenters argued that the limit should be completely eliminated. Still others argued that the limit should be increased, either up to 40 percent or to 50 percent of assets. One commenter suggested that an exception should be made for loans which are marketable on the secondary market. Based on the comments submitted and further study by the Board, the regulation is being amended to exclude adjustable rate mortgage loans from the limitation.

In requesting comments on whether or not to amend the limitation, the Board's primary focus was on the lack of an established secondary market for adjustable rate mortgage loans. Shortly after the proposed regulation was issued, however, the Federal National Mortgage Association announced its purchasing guidelines for adjustable rate mortgages. And since that time the pilot purchase program of the Federal Home Loan Mortgage Corporation has become operational. Nonetheless, for other reasons the Board is persuaded that no limitation should be placed on the use of adjustable rate mortgages.

Rather than concentrating on the effect of a developing secondary market, the commenters stressed other reasons for deregulating in this area. Several commenters emphasized that adjustable rate mortgage loans are designed to reflect current market conditions. Hence the risks associated with such loans for a lender are far less than the risks associated with fixed rate mortgage loans. Other commenters argued that eliminating the limitation with respect to adjustable rate mortgages would provide Federal credit unions with greater flexibility to serve their members. Such loans could prove to be a popular service depending on the lending standards of other financial institutions. The Board finds these arguments to be persuasive.

However, the Board is not convinced that the commenters have provided sufficient justification for changing the limitation with respect to fixed rate mortgage loans at this time. Although the regulation does allow for an increase in the limitation with the prior written consent of the Administration, to date only one request for an exception has been received. Consequently, contrary to the arguments made by some commenters, it does not appear that the limitation is impeding access to the secondary market by preventing a credit union from accumulating a pool of mortgages sufficiently large enough to sell on the secondary market.

In the case of fixed rate mortgage loans, the current limit strikes a balance which permits involvement in fixed rate mortgage loans without an adverse effect on liquidity. As one commenter has observed, a large fixed rate loan portfolio can significantly impair a credit union's ability to pay competitive dividends when the loans in its portfolio are earning less than prevailing market rates. This, in turn, can have a substantial effect on the credit union's stability. Hence, no change is contemplated at this time.

NCUA will continue to monitor requests for increases in the limitation on fixed rate mortgage loans. Consistent with its decision to permit the board of directors of each individual credit union to decide how to balance its loan portfolio between consumer and adjustable rate mortgage loans, in ruling on such a request NCUA will no longer focus primarily on the consumer loan program of the credit union. *See* 42 FR 59981 (1977) (factors NCUA previously considered in ruling on a request). Instead the primary factors NCUA will consider will now be the ability of the management of the credit union to operate a more extensive fixed rate mortgage loan program in a safe and sound manner and the evidence indicating that there is a demand for additional fixed rate mortgage loans. In addition, NCUA will reconsider its decision to retain the 25 percent of assets limitation with respect to fixed rate mortgage loans if a significant number of meritorious requests are forthcoming.

3. Due on Sale Clause

A due on sale clause is a type of acceleration clause. It gives the lender or the holder of the loan the option of calling the loan if the borrower sells or transfers all or part of his or her interest in the property securing the loan. A number of states, either by statute, regulation, or judicial decision, either limit or prohibit the enforceability of a due on sale clause in a residential real estate loan unless the lender can show an impairment of its security or risk of default as the result of the sale or transfer. As a result, several Federal credit unions and some credit union leagues had asked whether a Federal credit union may exercise its rights under a due on sale clause and raise the interest rate on a loan even if that would otherwise be prohibited by state law.

In response, NCUA proposed to add a new Subsection (d) to its regulation to clarify that when NCUA originally promulgated § 701.21–6 it was requiring a Federal credit union to use a due on sale clause in its conventional loan instruments. This was done (1) to balance the effect of changing market rates as between the lender and the borrower and (2) because the ability of the holder of a loan made by a Federal credit union to exercise the rights afforded under a due on sale clause is essential to the safe and sound participation of credit unions in the residential mortgage market. 46 FR 31654, 31655–56 (1981).

All the commenters supported NCUA's decision to require the use of a due on sale clause in conventional mortgage instruments notwithstanding state law. Two commenters did request that NCUA clarify that it would not require the use of a due on sale clause in the case of government insured or guaranteed loans. One commenter also recommended that the regulation specifically clarify that the holder of a loan made by a Federal credit union may exercise its due on sale option in order to raise the interest rate on loans in its portfolio. Since NCUA's intention was to require the use of the due on sale clause only in the case of conventional loans and since it was definitely NCUA's intention to permit the holder of a loan made by a Federal credit union to exercise the due on sale option in order to raise the interest rates on loan in its portfolio, appropriate clarifying language has been added to the regulation.

Procedures for Regulatory Development

The NCUA Board is not providing for a delayed effective date because the rules relieve a regulatory restriction and because delay would not be in the public interest in that it could hamper the ability of Federal credit unions to manage their loan portfolios in a safe and sound manner. 5 U.S.C. 553(d)(1), (3).

The NCUA Board certifies that the changes will not have a significant economic impact on a substantial number of small Federal credit unions (Federal credit unions with less than $1,000,000 in assets). The NCUA Board believes that only a few credit unions under $1,000,000 in assets are making long term real estate loans. Therefore a substantial number of small Federal credit unions would not be affected and a final regulatory flexibility analysis is not required. 5 U.S.C. 605(b).

Accordingly, NCUA amends § 701.21–6 of its existing rules and regulations as set forth below.

By the National Credit Union Administration Board on the 22d of July 1981.

Beatrix D. Fields,

Acting Secretary, NCUA Board.

(12 U.S.C. 1757, 1766(a), 1789(a)(11))

1. Section 701.21–6 is amended by revising the heading, paragraph (b)(4), and adding paragraph (d) to read as follows:

§ 701.21–6 Fixed rate mortgage loans.

* * * * *

(b) * * *

(4) The aggregate dollar amount of fixed rate real estate loans outstanding may not exceed 25 per centum of the Federal credit union's assets without prior written consent of the Administration. This limitation does not include real estate loans with maturities not exceeding twelve years.

* * * * *

(d) *Due on Sale Clause.*

(1) Notwithstanding any state law to the contrary, in the case of a conventional loan a Federal credit union is required to include a due on sale clause in its loan instruments whereby the holder of a loan made by a Federal credit union may, at its option, declare immediately due and payable all of the sums secured by the security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the holder's prior written consent. In the case of an Insured or Guaranteed loan, a Federal credit union is not required to include a due on sale clause in its loan instruments unless it is acceptable to the insuring or guaranteeing agency.

(2) Notwithstanding any state law to the contrary, the holder of a loan made by a Federal credit union may exercise a due on sale clause, for example, because of unsatisfactory creditworthiness of the person to whom the property is to be sold or transferred or because of a need to increase the overall yield in its loan portfolio, unless:

(i) Exercise of the due on sale clause would be based on any of the following:

(A) Creation of a lien or other encumbrance subordinate to the security instrument;

(B) Creation of a purchase money security interest for household appliances;

(C) Transfer by devise, descent, or by operation of law upon the death of a joint tenant; or

(D) Grant of any leasehold interest of three years or less not containing an option to purchase; or unless

(ii) Prior to the transfer the holder and the person to whom the property is to be sold or transferred reach written agreement that the credit of such person is satisfactory to the holder and that the interest payable to the holder on sums secured by its security instrument shall be at such rate as the holder shall request.

(3) This section is being promulgated pursuant to the plenary and exclusive authority of the NCUA Board as set forth in Sections 107(5)(A)(i), 107(5)(A)(ix), and 107(13) of the Federal Credit Union Act to regulate, respectively, the real estate loans granted by Federal credit unions, the amortization of loans granted by Federal credit unions, and the sale of loans granted by Federal credit unions. This exercise of the Board's authority preempts state laws purporting to address the ability of the holder of a loan made by a Federal credit union to exercise its rights under a due on sale clause to raise interest rates on loans.

[FR Doc. 81–22059 Filed 7–28–81; 8:45 am]

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12 CFR Part 701

Participation Loans; Purchase, Sale, and Pledge of Eligible Obligations

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: As part of its ongoing program of updating, clarifying, and simplifying existing regulations, the National Credit Union Administration (NCUA) has reviewed its regulation governing participation loans. As a result, NCUA is (1) amending the regulation to permit Federal credit unions to participate with other lenders in extending lines of credit to credit union members; (2) deleting from the regulation the requirement that specific provisions appear in the participation agreement; and (3) amending the regulation to permit the use of repurchase provisions. (Because NCUA's regulation governing the purchase, sale, and pledge of loans was drafted to impose the same restrictions on those activities that are placed on participations in order not to favor one arrangement over another, NCUA is also making similar changes in that regulation.) In addition, NCUA is (4) amending its regulation governing participation loans to clarify that the programs currently operated by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, and the Government National Mortgage Association are not participation loan programs as that term is used in NCUA regulations. Instead, credit union involvement in those programs is governed by NCUA's regulation on the purchase, sale, and pledge of loans.

EFFECTIVE DATE: July 22, 1981.

FOR FURTHER INFORMATION CONTACT: John L. Culhane, Jr., Senior Attorney, Office of General Counsel, National Credit Union Administration, 1776 G Street, NW., Washington, D.C. 20456. Telephone number: (202) 357–1030.

SUPPLEMENTARY INFORMATION:

Background and Summary of Comments

As part of its ongoing of updating, clarifying, and simplifying existing regulations, NCUA reviewed § 701.21–7, its regulation governing participation loans. As a result, NCUA proposed to make several changes in the regulation. 46 FR 31660 (1981). The major changes are summarized below.

First, NCUA proposed to amend the regulation to permit Federal credit unions to participate with other lenders in extending lines of credit to credit union members. Lines of credit were originally excluded because of concerns about operational problems and because no demonstrated need for including them had been expressed. The Board proposed to permit participations in lines of credit in order to place Federal credit unions on an equal competitive footing with Federal savings and loan associations and because the Board believes that decisions as to operational feasibility are generally best made by the board of directors of each individual credit union.

Second, NCUA proposed to delete from the regulation the requirement that specific terms appear in the participation agreement. Because participation lending was new to Federal credit unions, NCUA initially felt it was necessary to require that certain terms appear in the participation agreement. Thus, the agreement would cover otherwise unforeseen situations that might create problems and each participant would be treated equitably with regard to the distribution of payments of principal and the sharing of losses. Although the NCUA Board believes it prudent to include such provisions in an agreement, the Board proposed to remove the restrictions to permit Federal credit unions the same flexibility that other financial institutions have in drafting their participation agreements.

Third, NCUA proposed to permit the use of repurchase provisions.

Repurchase provisions were originally prohibited in order to prevent a credit union from having a large number of contingent liabilities that could affect its solvency at a later date. Nevertheless, the Board proposed to permit the use of repurchase provisions, although an agreement with a repurchase provision would normally be considered a borrowing, in order to allow Federal credit unions to compete with other lenders.

Fourth, NCUA proposed to amend its definition of participation loans to clarify that the programs operated by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, and the Government National Mortgage Association are not considered to be participation loan programs as that term is used in NCUA's regulations. This change was proposed to eliminate confusion as to whether the regulation would apply when a credit union obtains a pre-commitment of funds from one of those organizations, originates loans, and subsequently sells those loans to the organization. Instead of being covered by NCUA's participation loan regulation, such transactions are covered by NCUA's regulation on the purchase, sale and pledge of loans.

Comments on the proposal were received from Federal credit unions, credit union leagues, and credit union trade associations. The commenters overwhelmingly concurred with the proposal. One commenter did point out a typographical error in the proposed regulation; the word "obligation" appeared in the definition of a participation loan instead of the word "organization." Another commenter pointed out that the phrase "at a minimum," which appeared in those parts of the regulation dealing with minimum terms in the participation agreement, was now superfluous and could be deleted. These corrections have been made, but no substantive changes have been made in the final regulation.

In addition, two commenters requested clarification of NCUA's position on the use of repurchase or recourse provisions in participation agreements. As stated above, NCUA initially placed restrictions on the use of such provisions in order to prevent a credit union from having a large number of contingent liabilities which could affect its solvency at a later date. At the same time, NCUA hoped to provide sufficient flexibility so as not to impede a credit union from reacquiring a member's loan in cases where the member might be encountering temporary financial difficulties. Consequently, although the use of repurchase or recourse provisions was generally prohibited, a Federal credit union was permitted to enter into an agreement which required repurchase because of any breach of warranty or misrepresentation, an agreement which allowed the credit union to repurchase at its discretion, or an agreement which allowed the credit union to substitute one loan for another.

Nonetheless it appeared that the general prohibition on the use of recourse or repurchase agreements could have the effect of impairing the ability of Federal credit unions to compete with other financial institutions. The NCUA Board noted that national banks and Federal savings and loan associations are permitted to enter into participation agreements containing repurchase provisions. In both instances, however, an agreement containing a repurchase provision is considered to be a borrowing. NCUA therefore proposed to permit the use of agreements containing repurchase or recourse provisions but to treat such transactions as borrowings.

The NCUA Board believes that for safety and soundness reasons, the better view is that such transactions should normally be considered borrowings, subject to the statutory limit set out at 12 U.S.C. 1757 (i.e. 50 percent of the credit union's paid in and unimpaired capital and surplus), since they involve potential cash outflows at future dates. In essence, when a credit union enters into an agreement with another organization whereby that orgainization will fund part of a loan provided the credit union enters into a repurchase agreement, the transaction is the structural equivalent of a loan from that organization to the credit union. For example, if the obligation is one to repurchase at a fixed date the transaction is structurally similar to a single payment loan. When a credit union enters into an agreement with another organization whereby that organization will fund part of a loan provided the credit union enters into a recourse agreement (i.e. an agreement to repurchase on default), the transaction is also somewhat akin to a loan from that organization to the credit union. For example, if the obligation is one to repurchase in the event of default, the transaction is analogous to a loan which calls for repayment on the happening of a stated contingency.

The NCUA Board believes that this position will provide a Federal credit union with the ability to compete with other lenders while at the same time providing a measure of protection against a large number of contingent liabilities which could affect its solvency at a future date. Moreover, the Board notes that an exception is made in cases where the transaction is less similar to a borrowing. For example, provided there is no other obligation to repurchase, a transaction will not be considered a borrowing when the credit union agrees to repurchase a participation interest in the event of a breach of warranty or misrepresentation, or where the credit union agrees to repurchase at its discretion, or where the credit union agrees to substitute one loan for another loan.

Procedures for Regulatory Development

The NCUA Board is not providing for a delayed effective date because the rule relieves regulatory restrictions and because delay would not be in the public interest. 5 U.S.C. 553(d)(1), (3). Further delay would prevent Federal credit unions from participating with other lenders in extending lines of credit to their members and would prohibit Federal credit unions from drafting more flexible participation agreements, thus putting Federal credit unions at a competitive disadvantage

The NCUA Board certifies these changes will not have a significant economic impact on a substantial number of small Federal credit unions (Federal credit unions with less than $1,000,000 in assets). The NCUA Board believes that only a few credit unions under $1,000,000 in assets are making participation loans. Therefore, a substantial number of small Federal credit unions will not be affected. In addition, because these changes will increase the management flexibility of small credit unions, increase their competitive positions, and reduce their paperwork burden, a final regulatory flexibility analysis is not required. 5 U.S.C. 605(b).

Accordingly, NCUA amends §§ 701.21–7 and 701.21–8 of its existing rules and regulations as set forth below.

By the National Credit Union Administration Board on the 22d day of July 1981.

Beatrix D. Fields,

Acting Secretary, NCUA Board.

(12 U.S.C. 1757, 1766(a), 1789(a)(11))

§ 701.21-7 [Amended]

1. Section 701.21-7 is amended by removing paragraphs (a)(7) and (b)(3).

2. Section 701.21-7 is amended by redesignating paragraph (b)(4) as paragraph (b)(3).

3. Section 701.21-7 is amended by revising the introductory text of (a) and paragraphs (a)(1), (a)(5), and (b)(2) to read as follows:

§ 701.21-7 Loan participation.

(a) For purposes of this section:

(1) "Participation loan" means a loan made in participation with one or more eligible organizations, where the written commitment to participate in the loan precedes final disbursement.

* * * * *

(5) "Financial organization" means any federally chartered or federally insured financial institution.

* * * * *

(b) * * *

(2) Prior to final disbursement, a written participation agreement shall be properly executed, acted upon by the Federal credit union's board of directors or the investment committee and retained in the Federal credit union's office. The agreement shall include provisions which identify the participation loan or loans.

* * * * *

§ 701.21-8 [Amended]

3. Section 701.21-8 is amended by removing paragraphs (a)(4), (b)(3), (c)(2), and (c)(3).

4. Section 701.21-8 is amended by redesignating paragraph (b)(4) as paragraph (b)(3), by redesignating paragraph (c)(1) as paragraph (c), by redesignating paragraph (c)(1)(i) as paragraph (c)(1), and by redesignating paragraph (c)(1)(ii) as paragraph (c)(2).

5. Section 701.21-8 is amended by revising paragraphs (a)(1) and (d)(2) to read as follows:

§ 701.21-8 Purchase, sale and pledge of eligible obligations.

(a) For purposes of this section:

(1) "Eligible obligation" means a loan or group of loans;

* * * * *

(d) * * *

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

* * * * *

[FR Doc. 81-22001 Filed 7-28-81; 8:45 am]

BILLING CODE 7535-01-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 249

[Release No. 34-17966]

Annual Assessment Form for SECO Brokers and Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Adoption of form.

SUMMARY: The Securities Exchange Act of 1934 authorizes the Commission to collect such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed with respect to broker-dealers who are not members of a registered national securities association. This form sets forth the annual schedule under which such broker-dealers are to be assessed for fiscal year 1981.

EFFECTIVE DATE: Adoption of the Form is effective July 29, 1981. The Form is required to be filed on or before September 1, 1981.

FOR FURTHER INFORMATION CONTACT: William J. Finegan, Office of Applications and Reports Services, Room 7417, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, (202) 523-5543.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission announced today that it has adopted Form SECO-4-81 which sets forth the annual assessment payable to the Commission for fiscal year 1981 by registered broker-dealers who are not members of registered national securities associations ("SECO" broker-dealers).

In adopting Form SECO-4-81, the Commission has determined not to alter last year's schedule of fees and assessments. Thus, the gross municipal securities income assessment will remain .21% and the gross securities income assessment (exclusive of municipal securities) will remain .25%. These fees and assessments are being levied pursuant to Rule 15b9-2 of the Securities Exchange Act of 1934 (the "Act"). Rule 15b9-2 provides that, unless the Commission takes action to change them, the levels or rates of fees and assessments imposed on SECO broker-dealers will be set each year at the same levels or rates as the corresponding fees and assessments imposed by the National Association of Securities Dealers, Inc. on its members.

Notice of Date for Filing Form SECO-4-81

Rule 15b9-2 requires that nonmember broker-dealers file a Form SECO-4 for the particular year and pay the assessment specified therein by September 1 of each year.

Statutory Basis

The assessments for SECO broker-dealers are adopted pursuant to the Act and particularly Sections 15(b)(7), 15(b)(8), and 23(a) thereof. The Commission finds, in accordance with the Administrative Procedure Act ("APA") (5 U.S.C. 553(b)(3)(B)), that Rule 15b9-2 and Securities Exchange Act Release No. 17112 (September 3, 1980) (45 FR 59551 (September 10, 1980)) provided sufficient notice of the basis for and amount of these fees and assessments, that further notice is unnecessary as a prerequisite to the adoption of the requirements, and that there is good cause for the requirements to become effective on publication in accordance with the APA (5 U.S.C. 553(d)(3)) since Rule 15b9-2 establishes September 1 as the date for payment of fees. The Commission finds that any burden imposed upon competition by the amendments is necessary and appropriate in furtherance of the purposes of the Act, particularly the implementation of the Commission's continuing mandate under Section 15(b)(8) to collect such reasonable fees and charges as may be necessary to defray the costs of the specified regulatory duties required to be performed with respect to SECO broker-dealers. The Securities and Exchange Commission, pursuant to its authority under the Securities Act of 1934 (15 U.S.C. 78a *et seq.*, as amended by Pub. L. No. 94-29 (June 4, 1975)) and particularly Sections 15(b)(7), 15(b)(8), and 23(a) thereof, amends Part 249 of Title 17 of the Code of Federal Regulations by adding § 249.504o as follows:

§ 249.504o Form SECO-4-81, 1981, assessment and information form for registered brokers and dealers not members of a registered national securities association.

This form shall be filed on or before September 1, 1981, pursuant to § 249.15b9-2 of this chapter, accompanied by the annual assessment fee required thereunder and specified in the form, by every registered broker and dealer not a member of a registered national securities association. Those broker-dealers which are exempt from the payment of any assessment or fee pursuant to the provisions of § 240.15b9-2(e) must still file the form.

Note.—Copies of the form have been filed with the Office of the Federal Register, and additional copies are available on request from the Commission.

By the Commission.

Shirley E. Hollis,

Assistant Secretary.

July 23, 1981.

[FR Doc. 81-22147 Filed 7-28-81; 8:45 am]

BILLING CODE 6010-01-M

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 154

[Docket No. RM78-23]

Regulations Implementing Procedures for Refund of Louisiana First Use Tax by Primary Pipelines

Issued: July 17, 1981.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Interim rule and request for comments.

SUMMARY: The Commission amends paragraph (h) of 18 CFR 154.38 relating to the recovery of Louisiana First Use Tax by interstate pipelines. Specifically, the rule amends the procedures described in paragraph (h)(3) which require interstate pipelines to refund, with interest, any Louisiana First Use Tax collected by them in the event the First Use Tax is found invalid. Refunds are now required because the Supreme Court, in a judgment issued on June 15, 1981, *Maryland, et al. v. Louisiana*, 49 U.S.L.W. 4709 (1981), enjoined the State of Louisiana from further collection of the Louisiana First Use Tax on natural gas and directed Louisiana to refund all revenues collected pursuant to the First Use Tax together with all interest earned on those revenues upon the maturity date of each security in which the revenues and interest have been invested.

These amendments are necessary to conform § 154.38(h)(3) to the Supreme Court's judgment and to provide complete and speedy flow-through to jurisdictional pipeline customers of their First Use Tax payments. It requires interstate pipelines which receive LFUT fund refunds to pass those refunds in lump sum payment, by check, to their jurisdictional customers within certain time periods.

This rule contains provisions applicable to any pipeline which paid the First Use Tax directly to Louisiana ("primary pipeline"). A separate order will treat the interstate pipelines which will receive LFUT funds from other pipelines ("secondary pipelines").

DATES:

Effective Date: The interim rule is to be effective July 17, 1981, contingent upon approval by the Fifth Circuit Court of Appeals for leave to amend Order Nos. 10, 10-A, 10-B and 10-C.

Comments Date: Comments must be filed on or before August 12, 1981, and refer to Docket No. RM78-23. Submit an original and 14 copies.

ADDRESSES: Comments should be mailed to: Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426.

FOR FURTHER INFORMATION CONTACT:

Fredrick L. Jaffe, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, D.C. 20426 (202) 357-8363, or

Sherri L. Booye, Office of Pipeline and Producer Regulation, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, D.C. 20426 (202) 357-5378

SUPPLEMENTARY INFORMATION:

I. Introduction

By this rule the Federal Energy Regulatory Commission (Commission) amends paragraph (h) of 18 CFR 154.38(h), relating to the recovery of Louisiana First Use Tax by interstate pipelines. Specifically, the rule amends the procedures described in paragraph (h)(3) which require interstate pipelines to refund, with interest, any Louisiana First Use Tax collected by them in the event the First Use Tax is found invalid. Refunds are now required because the Supreme Court, in a judgment issued on June 15, 1981, *Maryland, et al.* v. *Louisiana*, 49 U.S.L.W. 4709 (1981), enjoined the State of Louisiana from further collection of the Louisiana First Use Tax on natural gas and directed Louisiana to refund all revenues collected pursuant to the First Use Tax together with all interest earned on those revenues upon the maturity date of each security in which the revenues and interest have been invested.[1] The first refund is to be made by Louisiana on July 15, 1981.

These amendments are necessary to conform § 154.38(h)(3) to the Supreme Court's judgment and to provide complete and speedy flow-through to jurisdictional pipeline customers of their First Use Tax payments. It requires interstate pipelines which receive LFUT fund refunds to pass those refunds in lump sum payment, by check, to their jurisdictional customers within certain time periods.

This rule contains provisions applicable to any pipeline which paid the First Use Tax directly to Louisiana ("primary pipeline"). A separate order will treat the interstate pipelines which will receive LFUT funds from other pipelines ("secondary pipeline").

II. Background

A. Louisiana First Use Tax

This Louisiana First Use Tax [2] was imposed, at a rate of 7 cents per thousand cubic feet ("Mcf"),[3] upon the first "use" [4] of certain natural gas within Louisiana. This tax principally affects natural gas entering Louisiana from the Outer Continental Shelf.[5]

B. Commission Orders

In Order Nos. 10, 10-A, 10-B, and 10-C,[6] the Commission established and refined procedures governing pipeline recovery of the First Use Tax. The primary purpose of each of these orders was to develop a mechanism which guaranteed that the customers of the pipelines would receive full refunds if the tax was found to be unconstitutional.[7]

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[1] Louisiana First Use Tax revenues collected by Louisiana and interest accrued thereon are hereinafter referred to as "LFUT funds."

[2] 1978 La. Sess. Law Serv. 482 (Act No. 294), La. Rev. Stat. Ann. §§ 47:1301-47:1307 (West 1979 Supp.). Hereinafter referred to as "First Use Tax."

[3] La. Rev. Stat. Ann. § 47:1303(B).

[4] The term "use" is defined broadly as "[1] the sale; [2] the transportation in [Louisiana] to the point of delivery at the inlet of any processing plant; [3] the transportation in [Louisiana] of unprocessed natural gas to the point of delivery at the inlet of any measurement or storage facility; [4] transfer of possession or relinquishment of control at a delivery point in [Louisiana]; [5] processing for the extraction of liquefiable component products or waste materials; [6] use in manufacturing; [7] treatment; or [8] other ascertainable action at a point within [Louisiana]. La. Rev. Stat. § 47:1302(8).

[5] Natural gas is subject to the First Use Tax if it is not subject to any severance or production tax levied by Louisiana or any other state or territory of the United States or is not subject to any import tax or tariff levied by the United States on imports from foreign countries. La. Rev. Stat. § 47:1303(a). Because almost every state, including Louisiana (La. Rev. Stat. §§ 47:631-47:646), imposes a severance or production tax on gas producted within the state, the First Use Tax only applies to gas not subject to state taxation. Such gas is produced from federal enclaves within a state, the federal portion of the Outer Continental Shelf (43 U.S.C. § 1331(a)(2)) or imported from a foreign country. This principal target of the tax is gas from the federal portion of the Outer Continental Shelf ("OCS gas") which enters Louisiana.

[6] 43 FR 45553 (October 3, 1978), 43 FR 60438 (December 28, 1978), 44 FR 13460 (March 12, 1979), 45 FR 29011 (May 1, 1980), petitions for review pending, *Tennessee Gas Pipeline Co., et al. v. FERC*, 5th Cir., Nos. 78-3816, *et al.*, and *Florida Gas Transmission Co. v. FERC*, 5th Cir., No. 79-1865.

[7] Throughout the Order No. 10 series, the Commission reiterated its belief that the First Use

Continued

The presently effective regulation, 18 CFR 154.38(h), provides that pipelines shall make full refunds plus interest within 60 days of the issuance of a final and nonappealable court order finding the First Use Tax invalid, or such other date established by Commission order. In light of the Supreme Court judgment discussed below, this interim rule modifies the 60-day refund provision, requiring pipelines to make refunds within certain time periods after the State of Louisiana disburses LFUT funds to the pipelines.

C. Supreme Court Opinion and Judgment

On May 26, 1981, the United States Supreme Court issued an opinion in *Maryland v. Louisiana* [8] finding the First Use Tax unconstitutional. The Supreme Court held that section 1303(C) of the First Use Tax violates the Supremacy Clause and that the entire First Use Tax is unconstitutional under the Commerce Clause of the U.S. Constitution.

On June 15, 1981, the Supreme Court issued a judgment in *Maryland v. Louisiana* [9] which enjoined Louisiana from further collection of the Louisiana First Use Tax and directed Louisiana to refund to the pipeline taxpayers within 30 days of the judgment all revenues collected pursuant to the First Use Tax, together with all interest earned thereon. At the request of the plaintiff states and the plaintiff-intervenors,[10] the Court further provided that the First Use Tax revenues which have been invested by Louisiana in interest bearing securities are to be refunded by Louisiana as each security matures, to avoid any interest penalty associated with premature termination of these securities. This staggered refund procedure will increase refunds to consumers by at least $17 million.

D. Commission Action Since the Supreme Court Judgment

In response to the Supreme Court's judgment which enjoined Louisiana from any further collection of the First Use Tax, the Commission issued an order on June 29, 1981, to terminate the collection of the First Use Tax by the pipelines from their customers.[11] The Commission order directed the twenty pipelines tracking the First Use Tax to cease collection of the tax from their customers, to terminate the tracking of the tax, and to file revised tariff rate sheets.

On July 8, 1981, the primary pipelines submitted to the Commission a proposed agreement which establishes the procedures by which Louisiana will refund LFUT funds to the primary pipelines. This agreement provides the method for allocating LFUT funds among the primary pipelines and establishes the dates on which Louisiana will make refunds to the primary pipelines. The total amount that will be refunded on July 15, 1981, exceeds $228,500,000.00 and certificates of deposit in face amounts of $403,325,000.00 will mature, with interest, between July 20, 1981, and May 14, 1982. The agreement between the primary pipelines and the State of Louisiana provides that funds paid on July 15, 1981, will earn interest to July 14, 1981, and generally that Louisiana will pay the remaining refunds within two business days of the maturity of each remaining certificate of deposit.[12] On July 13, 1981, the Commission approved the settlement agreement which was signed by the pipelines on July 10, 1981.[13]

E. Proposed Stipulation Submitted by 15 Primary Pipelines

On July 10, 1981, several primary pipelines submitted to the Commission a proposed stipulation for resolution of litigation in *Tennessee Gas Pipeline, et al. v. FERC*, 5th Cir. Nos. 78-3816, *et al.*, and *Florida Gas Transmission Co. v. FERC*, 5th Cir. No. 79-1865. Proponents of the stipulation indicate that the plaintiff states in *Maryland v. Louisiana, supra*, concur in the stipulation.

Tennessee Gas Pipeline Co. v. FERC involves a challenge by certain interstate pipelines to Commission Order Nos. 10, *et al.*, which, as noted above, established a Louisiana First Use Tax rate tracker pending the outcome of litigation regarding the constitutionality of that tax. The taxpaying pipelines questioned, *inter alia*, the legality of the rule which requires them to refund all tracker revenues, plus interest at six percent, within 60 days of a final and nonappealable court decision holding the First Use Tax statute unconstitutional—regardless of whether the State of Louisiana had refunded any tax collections to the taxpaying pipelines within that 60-day period. The case has been briefed and argued before the United States Court of Appeals for the Fifth Circuit. *Florida Gas Transmission Co. v. FERC* involves the same issues as *Tennessee*. It has been held in abeyance, pending decision in the lead case.

The proposed stipulation would substitute special refund procedures for the primary pipelines. The proposed stipulation sets forth procedures that the primary pipelines must follow to flow through to their jurisdictional customers the jurisdictional portion of LFUT funds as such funds are received from Louisiana. The stipulation requires the pipelines to refund to their customers the initial refund received from Louisiana within 30 days of disbursement and any subsequent refund received within 25 days of disbursement. If the pipelines fail to make the initial refund within 15 days or subsequent refunds within 10 days of disbursement, then these pipelines must pay interest computed at the prime rate on the amount not refunded for any additional time beyond the 15 days or 10 days, respectively.

The stipulation further provides that the pipelines may defer the flow through to their customers of any refund received from Louisiana that is under a threshold level[14] until they receive refunds which cumulatively exceed that amount. If that amount is not exceeded, the pipelines may defer the flow through until receipt of the last refund from Louisiana.

The proposed stipulation contains four other important provisions. First, it requires that the pipelines follow an allocation methodology for LFUT fund refunds which reflects the First Use Tax charges incurred by each pipeline customer.[15] Second, it requires that pipelines make refunds to their customers by check. Third, it provides for the termination of the First Use Tax deferred account surcharge with the balance in the account increasing or decreasing the pipelines' first LFUT fund refund. Finally, the stipulation requires

Tax was unconstitutional and from the very beginning the Commission directed the Commission's Solicitor to actively challenge the constitutionality of the tax.

[8] 49 U.S.L.W. 4562 (1981).

[9] 49 U.S.L.W. 4709 (1981).

[10] The United States and the Commission were plaintiff-intervenors.

[11] *Arkansas Louisiana Gas Company, et al.*, Docket Nos. TA81-2-31, *et al.* (Issued June 29, 1981).

[12] In addition to the July 15, 1981 refund date, Louisiana is required to disburse refunds to the primary pipelines on: July 22, 1981, August 19, 1981, September 16, 1981, October 21, 1981, November 18, 1981, December 16, 1981, March 17, 1982, April 21, 1982, and May 18, 1982.

[13] *Arkansas Louisiana Gas Company, et al.*, Docket Nos. TA81-2-31, *et al.*, "Order Approving Agreement" (Issued July 13, 1981).

[14] The threshold level is the lesser of $250,000 or one mill per Mcf (or Dkt) for the pipeline's total sales for the period during which the pipeline included charges relating to the First Use Tax in its sales rates.

[15] The stipulation provides that the LFUT fund refunds must be allocated among customers based on actual billings during the period that First Use Tax charges were made, if the billings are readily available. If the billings are not available, LFUT fund refunds must be allocated based upon billing determinants for that period.

the pipelines to make periodic reports to the Commission showing such information as: (1) the total amount of the refund received by each pipeline and the date of that refund (2) the total amount flowed through to each of its customers by customer and the date of the flow through, and (3) the methodology used to flow through refunds.

III. Policy Considerations

The constitutionality of the First Use Tax was questioned from the date of its enactment. Therefore, the Commission established uniform special procedures for the collection of the First Use Tax, subject to refund, and a requirement that the primary pipelines "keep accurate accounts of all amounts received under this paragraph, specifying when, by whom, and in whose behalf such amounts are paid."[16] While the interim rule alters the current regulation set up by Order No. 10–C,[17] it has the same basic goal as that of the Order 10 series—guaranteeing that the customers of the pipelines will receive prompt, full refunds of LFUT funds, according to the amounts they paid.

A. Need for a Special Uniform Refund Procedure

We continue to see the necessity for a uniform refund rule. Otherwise, pipelines would probably refund the LFUT funds in accordance with their existing tariffs. Generally, the tariff refund provisions provide that refunds should be made either through a credit to Account 191 or through a lump sum refund procedure for refund periods prior to January 1, 1980.[18] The Commission believes that the use of these tariff refund provisions for making LFUT fund refunds may not be adequate to assure that the refunds promptly flow back to those customers that have incurred the cost of the First Use Tax.

(1) *Allocation of LFUT Fund Refunds.* Tariffs which require lump sum refunds adopt various methods for allocating the refunds among customers. These tariffs, which are often the result of settlement agreements, may allocate refunds among customers differently than the way funds were collected when the First Use Tax was in effect. Tariff provisions which require refunds to be credited to Account 191 will likely allocate the refunds among customers in a manner different than they were collected simply because of changes in sales patterns over time. The interim rule adopts a uniform allocation methodology which more accurately reflects First Use Tax charges incurred by each customer than the tariff provisions presently in effect.

(2) *Prompt Refunds.* Tariff refund provisions may not allow for prompt refunds.[19] Refund provisions which require crediting of the refund to Account 191 may take as long as six to eight months (although earning interest in accordance with 18 CFR 154.67(d)) before the refund actually appears as a reduction to a pipeline customers' rates, if at all. If the *customer* is an interstate pipeline whose own refund tariff provisions also require crediting to Account 191, the process may be repeated.

The tariff provisions which require lump sum refund procedures may also delay flow through of LFUT funds to the ultimate consumer. Under most lump sum refund procedures, pipelines are not required to make refunds for at least 30 days from the date of receipt or until some refund threshold level is reached. The delay could be significant if, for example, the LFUT funds have to pass through 3 or 4 interstate pipelines with lump sum tariff provisions before reaching the ultimate consumer. The ultimate consumer may have to wait at least three or four months before receiving any refunds and as explained below, earn no interest during this delay. Since both existing tariff refund provisions—crediting of Account 191 and lump sum—do not expeditiously flow back refunds to consumers in a uniform manner, a special refund procedure is warranted.

(3) *Variation in Interest Requirements.* Finally, the significant variations in the interest requirements of the tariff refund provisions warrant adoption of a uniform interest requirement.[20] Some tariff refund provisions require that interest accrue from date of receipt;[21] others provide that no interest accures until forty-five days after receipt.[22] On refunds credited to Account 191, the tariff provisions often require, in accordance with the Commission's regulations,[23] that interest be computed on the month-ending balance in Account 191. This means that the interest requirement will vary from one refund to the next depending on what day the refund is received by the pipeline. A uniform refund procedure would require the same obligations from all pipelines and give the same protections to all customers, eliminating the inequity that a tariff approach would create.

For these reasons, the Commission does not believe it would be in the public interest to flow through LFUT fund refunds in accordance with each pipeline's tariff refund provision. The interim rule will serve to allocate more accurately the LFUT funds among customers who paid it, minimize the time period over which the refund must be made, and standardize the interest obligations of all pipelines. To the extent existing pipeline tariff refund provisions are inconsistent with this rule, the provisions of this interim rule shall apply.

B. Modification of the Primary Pipelines' Proposed Stipulation

The interim rule for the primary pipelines relies heavily on the proposed stipulation tendered to the Commission's Office of the Solicitor by fifteen of the primary pipelines as a proposed settlement of litigation in the U.S. Court of Appeals for the Fifth Circuit.[24]

The Commission chooses to codify the proposed stipulation as a interim rule instead of approving it as a settlement of the ongoing litigation for three practical reasons. First, not all twenty primary pipelines have agreed to enter into the stipulation.[25] Therefore, an interim rule is required for the remaining primary pipelines. Second, the Commission believes that persons affected by the proposed stipulation, not parties to the proposed stipulation, should have an opportunity to comment on the refund procedures we establish.[26] Execution of

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[16] 18 CFR 154.38(h)(2).

[17] The refund procedures are found in 18 CFR 154.38(h)(3).

[18] As a result of the Commission incremental pricing regulations implementing Title II of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3341–3348, lump sum refund procedures have been established in many pipeline tariffs to provide special lump sum refunds to non-exempt customers subject to the program.

[19] The tariff provisions are appropriate when a single supplier refund is involved for a particular pipeline. However, the LFUT refunds will be made on ten different dates over the next year by many interstate pipelines.

[20] The tariff provisions vary because they incorporate provisions of older settlement agreements.

[21] *See e.g.* National Fuel Gas Supply Corporation, First Revised Sheet No. 36C to FERC Gas Tariff Original Volume No. 1: Paragraph 4.3 "*Carrying Charges on Supplier Refunds.*"

[22] *See e.g.* Cities Service Gas Company Second Substitute First Revised Sheet No. 64 to FERC Gas Tariff Original Volume No. 1: Paragraph 21.41 "*Gas Suplies Refunds Subject to Flow Through.*"

[23] 18 CFR 154.38(d)(4)(iv)(c).

[24] *See* Section II. E. *supra*, for a summary of the litigation and the stipulation.

[25] There are five primary pipelines which have not yet concurred in the proposed stipulation: Panhandle Eastern Pipe Line Co., Trunkline Gas Co., El Paso Natural Gas Co., Arkansas Louisiana Gas Co., and Mid-Louisiana Gas Co.

[26] The comment procedures are set forth in IV., *infra.*

opportunity. Finally, the Commission believes that four minor substantive changes to the stipulation are warranted.

The first change modifies the stipulation's interest rate for LFUT funds in the pipelines' possession from the "current Citibank (N.A.) prime rate" to the interest rate in § 154.67(d) of the Commission's regulations, consistent with general Commission policy. It is a minor change to the interest rate requirement set forth in the stipulation, because the Commission's interest rate is based upon a three month average of the prime interest rate. However, it would eliminate any controversy over the term "current Citibank (N.A.) prime rate." The second change made by the rule to the stipulation is to modify the threshold level necessary before a primary pipeline is required to make a refund. The proposed stipulation may impose an unreasonable burden on certain interstate pipelines by requiring LFUT fund refunds if a pipeline receives the "lesser of $250,000 or one mill per Mcf (or Dkt) for the pipeline's total sales for the period during which the pipeline included charges relating to the First Use Tax in its sales rates pursuant to its Louisiana First Use Tax tariff provision." This provision could create an administrative burden for the interstate pipelines which in some cases may require the writing of refund checks for less than one dollar. To alleviate such an administrative burden and still protect the ultimate consumer, the interim rule requires refunds to be made if the pipeline receives LFUT funds which are "the greater of $250,000 or one fourth mill per Mcf (or Dkt) for the pipeline's total sales during the period April 1, 1979 to April 30, 1981." The third change clarifies the definition of "jurisdictional portion" in the allocation methodology by specifying that the jurisdictional portion must be computed on volumes "subject to First Use Tax charges." The fourth change requires the primary pipelines to file a schedule indicating amounts collected under the First Use Tax Tracker.

In all other respects, the Commission in the interim rule adopts the substantive procedures for primary pipelines set forth in the proposed stipulation and finds such procedures to be fair and equitable, and not unduly burdensome.

IV. Summary of the Rule

(1) *Method of Allocation.* The interim rule requires that all LFUT fund refunds made by primary pipelines be flowed through in lump sum payments by check to jurisdictional pipeline customers. The interim rule establishes an allocation methodology for LFUT fund refunds which reflects the First Use Tax charges incurred by each pipeline customer. Basically it requires the pipelines to allocate the refunds based upon the sales volumes of each customer subject to First Use Tax charges. The rule allows the primary pipelines to use a different methodology if it is based upon accurate records which the pipeline has kept.

(2) *Time Period for Making Refunds and Interest Provisions.* In the interim rule, the Commission requires the twenty primary pipelines which receive LFUT funds from Louisiana to make lump sum refunds within a specified time period after disbursement of the funds by Louisiana.[27] The rule requires these pipelines to make their first refund by August 14, 1981, on all LFUT funds disbursed by Louisiana to that pipeline on July 15, 1981. If the pipelines fail to make such refund by July 30, 1981, the rule provides that interest will be computed on the refund pursuant to § 154.67(d) of the Commission's regulations[28] from July 30, 1981, to the date the refund is disbursed to the pipelines' customers.

For each LFUT fund refund disbursed by Louisiana to the primary pipelines after July 15, 1981, the rule requires the pipelines to make refunds within 25 days of such disbursement. The primary pipelines are not required to pay any interest on refunds made within 10 days of the date Louisiana is required to disburse refunds to the pipelines. However, if refunds are not made within that 10 day period, the pipelines are required to pay interest in accordance with § 154.67(d) on these refunds from the 10th day after the date of disbursement by Louisiana to the date the refund is disbursed to the pipelines' customers.

The interim rule also requires, as of a specified date, the primary pipelines to stop collecting amounts necessary to amortize the balance in its First Use Tax Deferred Account and to add to or offset the next refund by the balance in that account. The rule further requires that the primary pipelines refund to each customer by check all payments still retained by the pipelines relating to the current First Use Rate Adjustment for the period on and after May 1, 1981.

Finally, the refund requirements for primary pipelines are subject to certain threshold triggers, with interest accruing after the primary 10 or 15 day period, in accordance with the proposed stipulation.

(4) *Refund Reports—Pipeline Compliance With Commission's Regulations.* In implementing the LFUT refund procedures, the Commission finds that there must be some mechanism by which it can assure that First Use Tax refunds are being made in compliance with its procedures. The interim rule requires them to make periodic reports to the Commission which show the following:

(1) The date of refund;

(2) The total amount of the refund received by the pipeline;

(3) The amount flowed through to each of its jurisdictional customers by customer;

(4) The date of each such flow through;

(5) The ratio used to determine the flow through for each of its jurisdictional customers and the basis on which that ratio was determined; and

(6) The amounts collected under the First Use Tracker.

IV. Effective Date and Comment Procedure

The interim regulations established by this rule are effective immediately, contingent upon leave of the United States Court of Appeals for the Fifth Circuit to amend the Commission's regulations regarding the primary pipelines. We shall direct our Solicitor to seek judicial authorization, as necessary.[29]

Publication of a proposed rulemaking for notice and public comment thereon and publication 30 days prior to the effective date of the rule have been omitted for good cause in accordance with section 553 of the Administrative Procedure Act, 5 U.S.C. 553 because delay in implementing the rule would be contrary to the public interest. The Supreme Court's judgment in *Maryland v. Louisiana, supra,* requires the State of Louisiana to refund a large portion of the LFUT funds by July 15, 1981. Unless the rule is effective immediately upon issuance (subject to permission of the

[27] In accordance with an agreement signed by the pipelines on July 10, 1981 and approved by the Commission on July 13, 1981, *Arkansas Louisiana Gas Company, et al.*, "Order Approving Agreement," Docket Nos. TA81-2-31 *et al.* Louisiana is required to make refunds to the twenty primary pipelines on the following dates: July 15, 1981, July 22, 1981, August 19, 1981, September 16, 1981, October 21, 1981, November 18, 1981, December 16, 1981, March 17, 1982, April 21, 1982, and May 18, 1982.

[28] The interest rate in § 154.67(d) is based upon a three month average of the prime interest rate.

[29] As noted above, Order Nos. 10, 10-A, 10-B, and 10-C are presently under court review in *Tennessee Gas Pipeline Co., et al. v. FERC*, No. 78-3816 (5th Cir.). Under Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b), the Fifth Circuit Court of Appeals presently has exclusive jurisdiction to affirm, modify, or set aside the Order No. 10 series. Therefore, the Commission must receive court approval before it can amend these orders.

Fifth Circuit) primary pipelines will, under current regulations, have to make refunds by August 14, 1981 (within 60 days of the Supreme Court judgment) of all amounts paid by them to Louisiana even though they will be receiving less from Louisiana by that date. Therefore, these new refund procedures must be immediately put into place so that interstate pipelines, distributors and state commissions can effectively flow through the refunds to the ultimate consumers.

Comments will be accepted on the interim rule and amendments to the rule will be considered with particular emphasis on any prospective refunds. Unless comments present compelling reasons to change provisions as to refunds made prior to issuance of the final rule, the Commission will not be inclined to impose any amendments retroactively.

Comments should be submitted to the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426. Each person submitting a comment should include his name and address and identify Docket No. RM78-23, and give reasons for any recommendations. An original and 14 copies should be filed with the Secretary of the Commission. All written submissions will be placed in the public file which has been established in this docket and which is available for public inspection in the Commission's Office of Public Information, Room 1000, 825 North Capitol N.E., Washington, D.C. 20426, during regular business hours. All comments should be received by the Commission by August 12, 1981.

Upon review of the comments, the Commission will consider whether public hearings are warranted.

(Natural Gas Act, 15 U.S.C. 717 *et seq.*; Department of Energy Organization Act, 42 U.S.C. 1701 *et seq.*; Administrative Procedure Act, 5 U.S.C. 553 *et seq.*)

In consideration of the foregoing § 154.38(h), Part 154 of Title 18, Code of Federal Regulations, is amended as set forth below, to become effective immediately, contingent upon approval by the Fifth Circuit Court of Appeals for leave to amend Order Nos. 10, 10-A, 10-B, and 10-C. Once judicial authorization to issue Order No. 10-D has been obtained, Order Nos. 10, 10-A, 10-B and 10-C, and the regulations adopted thereby, shall be deemed vacated as moot and the provisions thereof shall have no further effect, to the extent they are inconsistent with Order No. 10-D.[30]

[30] Since the primary pipelines will now be directed to make refunds to their customers only as LFUT fund refunds are received from the State of Louisiana, we believe that all issues are now moot in *Tennessee Gas Pipeline Co., et al.* v. *FERC*, 5th Cir. Nos. 78-3816, *et al.*, and *Florida Gas Transmission Co.* v. *FERC*, 5th Cir. No. 79-1865. We shall instruct our Solicitor to so inform the Court.

By the Commission, Commissioner Hughes dissented with a separate statement attached. Chairman Butler concurred with a separate statement attached.

Kenneth F. Plumb,

Secretary.

Section 154.38 is amended by revising paragraph (h)(3) to read as follows:

§ 154.38 Composition of rate schedule.

* * * * *

(h) *Pipeline recovery of the State of Louisiana First Use Tax.*

* * * * *

(3) A pipeline which receives LFUT funds from the State of Louisiana shall make refunds in accordance with the provisions of this subparagraph, notwithstanding any pipeline tariff provisions to the contrary.

(i) For the purposes of this subparagraph "LFUT funds" means First Use Tax refunds and interest accrued thereon due from the State of Louisiana in accordance with the June 15, 1981 Supreme Court judgment in *Maryland, et. al. v. Louisiana*, 49 U.S.L.W. 4709 (1981).

(ii) All refunds required by this subparagraph shall be flowed through in lump sum payments by check to jurisdictional pipeline customers in the amounts determined in accordance with paragraph (h)(3)(vi) of this section.

(iii) Except as provided in paragraphs (h)(3) (iv) and (v) of this section, a pipeline subject to this subparagraph:

(*a*) Shall refund to its jurisdictional customers on or before August 14, 1981, the jurisdictional portion of all LFUT funds disbursed by Louisiana to that pipeline on July 15, 1981. If a pipeline fails to refund such LFUT funds within 15 days after disbursement by Louisiana, then that pipeline must refund such funds with interest computed in accordance with § 154.67(d) of the Commission's regulations from the 15th day after the date of disbursement by Louisiana to the date the amount is disbursed to its jurisdictional customers.

(*b*) Shall refund the jurisdictional portion of all LFUT funds disbursed by Louisiana to such pipeline after July 15, 1981, to its jurisdictional customers within 25 days of such disbursement. If a pipeline fails to refund such LFUT funds within 10 days after disbursement by Louisiana, then that pipeline must refund such funds with interest computed in accordance with § 154.67(d) of the Commission's regulations from the 10th day after the date of disbursement by Louisiana to the date the funds are disbursed to its jurisdictional customers.

(*c*) Effective on the first day of the calendar month after this rule becomes effective, shall cease charging amounts required to amortize the balance in the account maintained pursuant to paragraph (h)(2) of this section, shall determine the balance in the account as of that date and increase (for a negative balance) or decrease (for a positive balance) the jurisdictional portion of the next LFUT refund by any remaining balance in such account.

(*d*) Within 5 days after this rule becomes effective, shall refund to each customer by check all payments relating to the current First Use Tax Rate Adjustment which were received by a pipeline applicable to the period on and after May 1, 1981, and which are still being held by the pipeline.

(*e*) Shall submit to the Commission on or before 15 days after flowing-through all LFUT funds disbursed from Louisiana on July 15, 1981, a refund report showing the following information:

(*1*) The total amount of the LFUT funds received by the pipeline;

(*2*) The date of that refund;

(*3*) The total amount flowed through to each of its jurisdictional customers by customer;

(*4*) The date of the flow through;

(*5*) The ratio used to determine the flow through for each of its jurisdictional customers and the basis on which that ratio was determined pursuant to paragraph (h)(3)(vi) of this section; and

(*6*) The amounts collected under the First Use tracker.

(*f*) Shall submit to the Commission on or before December 15, 1981, on or before March 15, 1982, and finally, on or before June 15, 1982, refund reports showing for each LFUT fund disbursed from Louisiana since its most recent prior report:

(*1*) The date of such LFUT fund disbursement;

(*2*) The total amount of the LFUT funds received by the pipeline;

(*3*) The amount flowed through to each of its jurisdictional customers by customer;

(*4*) The date of each such flow through; and

(*5*) The ratio used to determine the flow through for each of its jurisdictional customers and the basis on which that ratio was determined pursuant to paragraph (h)(3)(vi) of this section.

(iv) For the purposes of determining the date interest begins to accrue under paragraph (h)(3)(iii) of this section, it shall not begin on a Saturday, Sunday of holiday, but on the next business day.

(v) A pipeline may defer the flow through of any LFUT funds refunded to it until either:

(*a*) It has accumulated LFUT funds which cumulatively equal or exceed the greater of $250,000 or one-fourth of a mill per Mcf (or Dkt) for the pipeline's total sales during the period April, 1979, to April, 1981 at which point the pipeline shall refund the jurisdictional portion of all LFUT funds received in accordance with paragraph (h)(3)(v)(*c*) of this section; or

(*b*) If it has not accumulated LFUT funds which cumulatively equal or exceed the greater of the alternative trigger levels described in paragraph (h)(3)(v)(*a*) of this section, then upon receipt of its last LFUT funds, each pipeline shall refund to its jurisdictional customers the jurisdictional portion of all LFUT funds which it has received but not yet flowed through to its jurisdictional customers in accordance with paragraph (h)(3)(v)(*c*) of this section.

(*c*) The pipeline shall refund the LFUT funds within 25 days from the day paragraphs (h)(3)(v) (*a*) or (*b*) of this section requires the flow through of the LFUT funds. The pipeline shall refund such funds with interest computed in accordance with § 154.67, from the 10th day after such LFUT funds are disbursed by Louisiana (15th day in the case of the first Louisiana refund) to the date the refund is disbursed to its jurisdictional customers.

(vi) Any LFUT funds received by a pipeline shall be flowed through each jurisdictional customer of such pipeline in amounts determined in the following manner:

(*a*) If the amount the pipeline collected pursuant to its First Use Tax tariff provision may be determined readily and expeditiously from its books and records, then multiply the jurisdictional portion of the total amount of each LFUT fund refund received by the pipeline by the ratio of the LFUT tracker amount which the pipeline billed the customer for the period from April, 1979, through April, 1981, pursuant to its Louisiana First Use Tax tariff provision to the total amount which the pipeline billed as a LFUT tracker during the same period pursuant to that tariff provision; or

(*b*) If paragraph (h)(3)(vi)(*a*) of this section does not apply, then multiply the jurisdictional portion of the total amount of each refund received by the pipeline by the ratio of the total commodity billing determinants of the customer during the period from April, 1979, through April, 1981, to the pipeline's total jurisdictional commodity billing determinants during that period.

(*c*) The jurisdictional portion of each refund received by a pipeline shall be computed by multiplying the amount so received by a fraction the numerator of which is the total volume sold by such pipeline to jurisdictional customers during the period from April, 1979, through April, 1981 which were subject to First Use Tax charges, and the denominator of which is the total volume sold by such pipeline to all customers during such period which were subject to First Use Tax charges.

* * * * *

Hughes, Commissioner, Dissenting:

This order allows a group of 20 primary pipelines 15 days interest free use of over a quarter billion dollars which belong to their customers.[1] By any conservative interest calculation, this amounts to at least two million dollars. At today's interest rates, even one day's interest free use of this amount could pay several Commissioners' salaries for a year.

The Commission issued Order No. 10 to deal with the Louisiana First Use Tax ("LFUT") while the constitutionality was being challenged. In accordance with the order, the pipelines collected the estimated LFUT from their customers and paid it to Louisiana. The purpose of the order was to ensure full and prompt refund of the monies to the consumers.

The Supreme Court held that the Louisiana First Use Tax was unconstitutional. *Maryland, et al.* v. *Louisiana*, 49 U.S.L.W. 4562 (May 28, 1981). On June 15, 1981, the Court issued its decree which enjoined further collection of the tax and directed refund of all revenues collected together with all interest earned thereon by the State of Louisiana.

In summary, the Commission, in Order No. 10, and the Supreme Court have provided for return of the monies to the consumers who paid the tax initially. Neither Order No. 10 nor the Supreme Court decree anticipated a profit through interest income to Louisiana or the pipelines.

Therefore this order is inconsistent with the previous Order No. 10 and the Supreme Court decree in so far as it allows the pipelines interest free use of the refund money. The Order allows the pipelines 15 days carte blanche use of the money disbursed by Louisiana on July 15. On subsequent disbursements, the pipelines have 10 days interest free use of the money. This issue is largely one of unknown origin to the Commission since we did not participate in the litigation or the settlement discussions. We therefore did not have the benefit of participation in the give and take of negotiation nor the data necessary for the assessment of impact of this flow-through issue.

No one has demonstrated the administrative costs of tracking the interest earned, but given contemporary commercial practices replete with computerized data processing capabilities, such cost, it would appear, could be quickly ascertained. Thus, to the extent the decision might be justified on the basis of administrative burden, it would fail for lack of supporting data.

Others may question the proper method to measure the interest earned. I do not doubt that the return on the money may vary from pipeline to pipeline. Nonetheless, actual interest received could be revealed with disclosure of such actual interest not being an insurmountable obstacle; the labor involved is no justification for allowing for the interest free use of funds.

In any event, were the Commission to find that the pipelines did incur costs associated with the refund, there are a number of measures available to offset the interest income by such expenses. No attempt has been made to make such an adjustment. The result could lead to a serious unfairness to customers which I now hope the Court will address.

J. David Hughes,
Commissioner.

Butler, Chairman, Concurring Specially

These concurring views are intended to express my perspective of Commissioner Hughes' dissent. He has raised a concern in connection with the interim order that I share. There is no doubt that the interstate natural gas pipeline companies are sophisticated in the exercise of modern cash management practices, and that the exercise of those practices in the times during which the pipelines will hold the substantial sums of money to be refunded could—and undoubtedly will in some cases at least—result in not insubstantial interest to several pipelines.

A review of the approximated amounts of interest illustrates my difficulty with the dissent. Essentially, that difficulty is that the dissent offers an explication of a problem, but does not offer a solution. It leaves open the following questions, for example: Clearly, some pipelines will make substantial interest (*e.g., Tennessee*), but the interest to others will be negligible (*e.g., Mississippi River*). Do we require *all* to refund actual interest, or do we treat pipelines differently by considering the amounts of refunds in some, but not all, cases to be *de minimis*? If so, what is the standard? If we require all pipelines to refund all interest, have we not encouraged the pipelines to waste the time value of the money by *avoiding* the deposit of the funds in interest-bearing accounts in order to avoid the administrative hassle of making *de minimis* refunds? Would compensation of the pipelines for not wasting the time value of the money include reimbursement of out-of-pocket costs plus an "incentive" profit of some kind, or just the costs?

The problem with the dissent is that it is a statement of principle with which no one on

[1] In Order —— the secondary pipelines are allowed 15 days interest free use of the refund money. Although the time period and thus the profit involved are smaller, I object to that decision for the same reasons stated in this dissent.

the Commission could disagree, but it fails utterly to offer solutions to the problems that it raises itself. This may be inevitable because my colleague did not have the time to fashion a solution, but his difficulty is our difficulty. Neither did we. Offsetting the apparent inequity to the consumer, however, are several considerations. First, the Commission staff was not privy to the settlement negotiations, so we do not have any way of knowing what might have been traded among the pipelines and the states for this advantage to the pipelines. Secondly, the states represent their gas consumers, as well as the Commission. Indeed, that was the point of the lawsuit in the first place, and I for one am disinclined to suggest that the states have not done a good job of protecting the consumers resident therein. Finally, our Order No. 10–C would have allowed the refunds to be made in 30 days, and that time is substantially shortened by the agreement and thus by our interim order. That suggests to me that the states did not ignore its consumers, nor has the Commission, as the dissent implies. For these reasons, I believe the Commission has chosen the appropriate course of action under the circumstances in its interim order.

C. M. Butler III,

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18 CFR Part 271

[Docket No. RM79-76 (Colorado-10)]

Colorado; High-Cost Gas Produced From Tight Formations

July 24, 1981.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission is authorized by section 107(c)(5) of the Natural Gas Policy Act of 1978 to designate certain types of natural gas as high-cost gas where the Commission determines that the gas is produced under conditions which present extraordinary risks or costs. Under section 107(c)(5), the Commission issued a final regulation designating natural gas produced from tight formations as high-cost gas which may receive an incentive price (18 CFR 271.703). This rule established procedures for jurisdictional agencies to submit to the Commission recommendations of areas for designation as tight formations. This final order adopts the recommendation of the Colorado Oil and Gas Conservation Commission that the Morrow Formation be designated as a tight formation under § 271.703(d).

EFFECTIVE DATE: This rule is effective July 24, 1981.

FOR FURTHER INFORMATION CONTACT: Leslie Lawner, (202) 357–8307, or Victor Zabel, (202) 357–8616.

SUPPLEMENTARY INFORMATION:

The Commission hereby amends § 271.703(d) of its regulations to include the Morrow Formation in Kiowa County, Colorado as a designated tight formation eligible for incentive pricing under § 271.703. The amendment was proposed in a Notice of Proposed Rulemaking by Director, OPPR, issued February 4, 1981 (46 FR 11841, February 11, 1981) [1] based on a recommendation by the Colorado Oil and Gas Conservation Commission (Colorado), in accordance with § 271.703(c), that the Morrow Formation be designated as a tight formation.

Colorado filed the recommenation under the alternative procedure specified in § 271.703(c)(2)(ii). This alternative procedure applies to formations which meet the stabilized production rate guideline (§ 271.703(c)(2)(i)(B)), and the crude oil production guideline (§ 271.703(c)(2)(i)(C)), but do not meet the permeability standard set forth in § 271.703(c)(2)(i)(A). As in this instance, the formation may be approved as a tight formation if the jurisdictional agency makes an adequate showing that the recommended formation exhibits low permeability characteristics and that the incentive price set in § 271.703(a) is necessary to provide reasonable incentives for production of natural gas from the formation due to the extraordinary costs associated with such production.

Colorado's submission contained extensive geological data which, upon analysis, demonstrated that the recommended formation exhibits low permeability charcteristics. Such data included information on the composition of the recommended formation, as well as the drilling history of the formation. Specific engineering data from one well was also presented as an example of low permeability encountered in the formation.

Colorado submitted, in addition to the technical data addressing permeability, information and analyses of an economic nature to establish the fact that the tight formation incentive price is necessary to provide reasonable incentives for the production of gas from the recommended formation.

The Commission has reviewed the Colorado submission, and believes that Colorado has demonstrated both the low permeability characteristics of the recommended formation and the fact that the price established for natural gas produced from tight formations is necessary to provide reasonable incentives for production of the natural gas from the recommended formation due to the extraordinary costs associated with such production.

The Commission finds that the evidence submitted by Colorado and the commenters supports Colorado's assertion that the Morrow Formation meets the guidelines contained in § 271.703(c)(2). The Commission adopts the Colorado recommendation.

This amendment shall become effective immediately. The Commission has found that the public interest dictates that new natural gas supplies be developed on an expedited basis, and therefore, incentive prices should be made available as soon as possible. The need to make incentive prices available as soon as possible establishes good cause to waive the thirty-day publication period.

(Department of Energy Organization Act, (42 U.S.C. 7101 *et seq.*), Natural Gas Policy Act of 1978, (15 U.S.C. 3301–3432); Administrative Procedure Act, (5 U.S.C. 553))

For the reasons stated herein, Part 271 of Subchapter I, Title 18, *Code of Federal Regulations*, is amended as set forth below, effective July 24, 1981.

By the Commission.

Kenneth F. Plumb,

Secretary.

Section 271.703(d) is amended by adding a new subparagraph (45) to read as follows:

§ 272.703 Tight formations.

* * * * *

(b) *Designated tight formations.* The following formations are desingated as tight formations. A more detailed description of the geographical extent and geological parameters of the designated tight formations is located in the Commission's official file for Docket No. RM79–76, as subindexed below, and is also located in the official files of the jurisdictional agency that submitted the recommendation.

* * * * *

(45) *The Morrow Formation in Colorado.* RM79–76 (Colorado—10).

(i) *Delineation of formation.* The Morrow Formation is found in Kiowa County, Colorado. It is located north of the town of Lamar in southeastern Colorado, and underlies all of Township 18, South, Range 45 West, 6th p.m.

[1] Comments on the proposed rule were invited and favorable comments were received. No party requested a public hearing and no hearing was held.