

Rules and Regulations

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Mergers or Conversions of Federally-Insured Credit Unions to Non Credit Union Status: NCUA Approval

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The final rule applies to any credit union that is insured by the National Credit Union Share Insurance Fund (NCUSIF) and that proposes to merge into or convert to any non credit union institution. The rule imposes new substantive requirements. The purposes of these requirements are to ensure that such transactions take place only pursuant to an informed vote of the credit union's members/owners, to prevent self-dealing and other abuses by individuals involved in the transactions and to ensure that these transactions do not present safety and soundness risks to the NCUSIF and the credit union system. State chartered NCUSIF insured credit unions may, on a case-by-case basis, obtain a waiver from NCUA's rules if state laws and procedures are determined to adequately address these concerns.

EFFECTIVE DATE: April 1, 1995.

FOR FURTHER INFORMATION CONTACT:
Mary F. Rupp, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428 or telephone: (703) 518-6553.

SUPPLEMENTARY INFORMATION:

Background

In June 1994, the NCUA requested comments on proposed changes to part 708 of its regulations. At that time, part 708 only addressed situations where an NCUSIF insured credit union dropped NCUSIF insurance, either through a

merger into a non NCUSIF insured credit union or through a voluntary termination or conversion of insurance. It did not cover the merger or conversion of a credit union into a non credit union institution. The Federal Credit Union Act, however, vests the NCUA Board with the responsibility to regulate such mergers or conversions. 12 U.S.C. 1785(b). The proposed changes to part 708 clarified that NCUA approval requirements apply to all mergers and conversions where the continuing institution is not insured by NCUSIF. 59 FR 33702 (June 30, 1994).

The proposal was in response to abuses that had occurred with bank and thrift conversions, some isolated instances in the credit union system, and recent solicitations by outside consultants and attorneys to federally insured credit unions for conversion to non credit union charters. The solicitations often appeared motivated by benefits to the attorneys, consultants and insiders, rather than the members. The amendment was deemed necessary "to provide NCUA with clear authority to prevent abuses in connection with conversions of insured status." 59 FR 33702. The comments to the proposal were generally positive and consistently stressed that the members need to be properly informed and that the NCUA needs to ensure that safety and soundness and members' interests are protected.

On September 16, 1994, the NCUA Board issued an interim final rule and request for further comment. The rule was effective upon publication on September 23, 1994. 59 FR 48790. The new rule, part 708a, established that the NCUA Board must approve any merger or conversion of a federally-insured credit union to any non credit union institution, including preapproval of any notices to members that are sent out in connection with the merger or conversion. At the same time, the Board requested further comment on a number of issues related to the application and approval process.

Summary of Comments and Discussion of Issues

In the June 1994, proposal, the NCUA Board requested comment on the general issue of NCUA regulation in this area and on the specific issue of uniform member notice. In the interim rule, comment was requested on a number of

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issues that the Board felt required further consideration and review. The NCUA received 16 comments on the proposed rule: 10 from credit unions; 4 from credit union trade groups; 1 from a bank trade group; and 1 from a credit union league. The NCUA received 19 comments on the interim rule: 6 from federal credit unions; 6 from federally insured state chartered credit unions (FISCUs); 3 from credit union trade groups; 2 from bank trade groups; and 2 from state regulators. The following is a combined summary of the comments received on the proposed rule and the interim final rule.

1. NCUA Oversight

In the proposed rule, 14 commenters addressed the issue of NCUA oversight. Twelve expressed general support for NCUA oversight and two expressed general opposition. The supportive commenters cited the following benefits of NCUA regulation: Eliminate confusion, prevent unnecessary litigation, protect the members from potential abuse, assure that the members know the advantages and disadvantages of any proposal, protect the assets and integrity of the NCUSIF and assure that financial benefits to insiders are fully disclosed. The two negative commenters were a bank trade group and a state chartered credit union. The bank trade group characterized the proposal as an overreaction by NCUA to a few isolated examples.

The issue of NCUA's jurisdiction over mergers or conversions by federally-insured state credit unions (FISCUs) was raised by 5 commenters on the interim rule. The five consisted of the professional group that represents state credit union supervisors (the National Association of State Credit Union Supervisors, or NASCUS), two FISCUs and two state regulators. All strongly opposed any NCUA regulation of mergers or conversions of FISCUs.

NASCUS made the point that only seven of the 48 states which charter credit unions allow them to merge with other financial institutions and only four states allow credit unions to convert into another form of financial institution. NASCUS' comment also recognized, however, that several states have statutes that are silent on the issue. It is those states which cause the Board the most concern. Without specific

regulations in this area, there is potential for abuse.

The NCUA Board believes that basic regulatory standards applicable to all NCUSIF insured credit unions are necessary to safeguard the integrity of the process and to ensure that issues of safety and soundness and fiduciary duty are properly addressed. The Board has attempted, however, to balance these concerns with a deference to the important role of the state supervisors. As it is NCUA's intention to work with the state supervisor in cases involving federally-insured state credit unions, the Board has crafted a final rule that would allow FISCUs to merge or convert if they have the state's authority to do so. In those instances, the FISCU may file a written request with the NCUA Board for a waiver of compliance with the procedural portions of part 708a and instead follow the applicable state regulation. The request would have to demonstrate that the waiver would not be detrimental to the safety and soundness of the credit union, that there is no possibility of self-dealing or other breach of fiduciary duty by the credit union's management or others involved in the transaction, and that the members' interests are adequately protected.

2. Insider Preferences

The proposed rule asked whether directors and management officials involved in the conversion process should be allowed to receive any personal financial benefit from the transaction, other than that available to ordinary members. The ten commenters responding to this question agreed that directors and management should not be allowed to receive any compensation in excess of that available to other members. Several commenters suggested NCUA enact strong regulations in this area. As well as limiting the compensation available to insiders, one commenter suggested individuals should not be guaranteed employment at the continuing institution, noting that this would remove the incentive for insiders encouraging a merger that is not in the best interest of the members.

A related issue is that of what post-merger or post-conversion controls are needed to protect against improper insider preferences after the transaction is completed. Some of the suggestions of the five commenters who commented on this issue were that NCUA should prohibit stock acquisition by insiders for a period of five years and that both pre- and post-merger or conversion controls are necessary to prevent insider abuse. One of the trade groups suggested a way

to avoid the problem would be to condition approval of the transaction "on a return of equal shares of equity to all members before the execution of the charter change."

The recommendations of the commenters have been modified and incorporated into the final rule as follows: For a period of two years after the transaction, directors may not receive any benefits not otherwise equally available to other members, and directors and senior management officials may not acquire stock in the continuing institution or its successor on terms not available to the other members of the credit union. These prohibitions on directors and senior management officials must remain in effect for at least two years following the merger. In order to enable NCUA to ensure compliance with these prohibitions, the affected individuals will be required to enter into written agreements with NCUA. The NCUA Board decided not to require a distribution of reserves and undivided earnings to members, as such a requirement would have the practical effect of prohibiting the transactions covered by the rule. Among the disclosures required to be provided to the members, however, is a clear explanation of the change in the nature of their ownership interest in reserves and undivided earnings that will result from the transaction.

3. Majority Approval

NCUA requested comment on whether a majority of eligible voting members should be required to approve the transaction. Comment was further requested on whether majority should be defined as a simple majority or a super majority, and, if a super majority, how it should be defined. The six commenters that addressed the issue all agreed that a majority of the voting members should be required for approval. Two defined majority as over 50%, two defined it as 60% to 63 1/3%, one defined it as 70% to 80% and the other commenter did not define it.

Recognizing the importance of a clear mandate on an issue of such significance to the members, the final rule requires that a majority of all eligible voters approve any transaction covered by the rule.

4. Appraisal

In those cases the Board is aware of where credit unions have considered conversions or mergers to non credit union charters, the first step of the transaction would be to move from a credit union charter to a mutual savings bank charter. In cases where the

ultimate goal is to become a stock institution, conversion from mutual to stock would be proposed as a second, but virtually simultaneous step.

For those cases involving this second step, the Board specifically asked for comment on how to properly appraise the value of the credit union for purposes of issuing stock. This issue is important to the members, who, as noted above, are entitled to acquire stock on the same terms and conditions as directors and senior management officials. Seven commenters had suggestions on this issue. One recommended that a professional appraisal be performed, three recommended that the value of the stock include accumulated capital and one suggested the new regulator determine the value of the stock. One trade group suggested it be handled as a liquidation and payout and another suggested NCUA turn to state law for guidance.

After considering the comments and reviewing the other agencies' rules in this area, the Board has determined to simply require that an appraisal be performed and included in the application. The Board will review the appraisal as part of its review of the application.

5. Uniform Member Notice

The proposal requested comment on whether the rule should include a uniform member notice. Nine of the ten commenters responding to this issue supported a uniform notice.

Commenters suggested that a uniform notice would provide clear and consistent guidelines for merging institutions, ensure that important information is not withheld from the members and require less individual review. The Board agrees with these goals, but believes they can be accomplished more effectively through a listing of the information that must be included in the notice to members, rather than a form which may become outdated or not apply to all transactions.

Overview of Final Rule

The final rule adopts with minor modifications the interim rule and expands upon it to impose substantive and procedural requirements that the Board has determined are necessary to ensure an informed membership vote, to safeguard against potential safety and soundness problems and to prevent breaches of fiduciary duty. The final rule, part 708a, tracks in large part the current part 708b. Its key provisions are as follows: NCUA Board approval is required in advance of any transaction whereby a federally insured credit union transfers all or any part of its

members' shares or similar accounts to any non credit union institution; a majority of all members of record must vote to approve the transaction; directors must agree to receive no benefits in excess of those available to the members; notice to members must be preapproved by the NCUA Board and must include all pertinent information required by the rule as well as any additional information deemed necessary on a case by case basis; FISCUs may only engage in the transaction if they obtain approval from the state authority to proceed with the merger or conversion; and FISCUs must follow part 708a unless they obtain a waiver from NCUA.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small credit unions. It is highly unlikely that small credit unions (those under \$1 million in assets) would be engaged in a merger or conversion to a non credit union institution. The final rule merely clarifies statutory authority. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

These amendments do not change paperwork requirements.

Executive Order 12612

This rule applies to all federally insured credit unions. The rule clarifies existing statutory requirements of NCUA Board approval of certain transactions involving federally insured credit unions. Recognizing the interests of states and state regulators in supervising state chartered credit unions, the NCUA Board has included a provision in the final rule that allows FISCUs, on a case-by-case basis, to obtain a waiver from NCUA's rule and follow state procedures if those procedures are determined to adequately address the concerns of NCUA's rule. With this provision, the NCUA Board has determined that this amendment is not likely to have any direct effect on states, on the relationship between the states, or on the distribution of power and responsibilities among the various levels of government.

List of Subjects in 12 CFR Part 708a

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on March 1, 1995.
Becky Baker,
Secretary of the Board.

Accordingly, the interim rule adding a new regulation in 12 CFR part 708a which was published at 59 FR 48790 on September 23, 1994, is adopted as a final rule with changes as follows:

PART 708a—MERGERS OR CONVERSIONS OF FEDERALLY-INSURED CREDIT UNIONS TO NON CREDIT UNION STATUS: NCUA APPROVAL

1. The authority citation for part 708a continues to read as follows:

Authority: 12 U.S.C. 1766, 12 U.S.C. 1785.

2. Sections 708a.1 and 708a.2 are revised to read as follows:

§ 708a.1 NCUA Board Approval.

Section 205(b)(1) of the Federal Credit Union Act requires NCUA Board approval in advance of any transaction whereby a federally-insured credit union transfers all or any part of its members' accounts to any non credit union institution. This part establishes rules and procedures for any merger, conversion or other transaction in which a federally-insured credit union's share accounts or similar member accounts are transferred to a non credit union institution. Transactions where a federally-insured credit union transfers member accounts to another credit union are subject to the provisions of part 708b of this chapter. Compliance with this part 708a is in addition to any other federal or state laws and regulations which may be applicable to the proposed transaction, including state corporate laws and state and federal securities laws.

§ 708a.2 Plan for Merger or Conversion to a Non Credit Union Institution.

(a) *Proposition for merger or conversion.* The board of directors of the credit union shall approve a proposition for merger or conversion.

(b) *Plan for merger or conversion.* Upon approval of a proposition for merger or conversion by the board of directors, a plan for the transaction shall be prepared. The plan shall include:

- (1) Current financial reports;
- (2) Current delinquent loan schedules annotated to reflect collection problems;
- (3) Combined financial report, if applicable;
- (4) Contingencies;
- (5) Explanation of any provisions for reserves, undivided earnings or dividends;

(6) Analyses of share values and explanation of any adjustments to member's share accounts;

(7) Analyses of the regulatory effect of the merger or conversion brought about by the change in government regulator;

(8) Explanation of any other relevant effects on the members; and

(9) Any additional information, as required by the NCUA Regional Director.

(c) *Nonpreferential treatment.* The plan for merger or conversion shall provide that, for a period of at least two years after the effective date of the transaction:

(1) No director of the credit union may receive any compensation or any benefits not provided or available to other members; and

(2) No director or senior management official of the credit union shall be allowed to acquire stock in the resulting or continuing institution or any successor institution, on any terms other than those readily available to all members of the former credit union. This prohibition would include stock issued for services rendered prior to the merger or conversion. For purposes of this section, *senior management official* means the credit union's chief executive officer, any assistant chief executive officers and the chief financial officer.

3. Sections 708a.3, 708a.4, 708a.5, 708a.6 and Appendix A are added to read as follows:

§ 708a.3 Submission of Proposal to NCUA.

(a) *Submissions to the NCUA Regional Director.* Upon approval of the plan by the board of directors of the credit union, the following will be submitted to the appropriate NCUA Regional Director:

(1) The plan, as described in § 708a.2(b) of this part;

(2) A resolution of the board of directors approving the plan;

(3) A written agreement from each member of the board of directors and each senior management official to comply with the terms of § 708a.2(c) (the agreement shall be executed by NCUA as well, in the event of approval of the transaction);

(4) A proposed merger or conversion agreement;

(5) A proposed Notice of Meeting, as described in Appendix A of this part;

(6) A copy of the form ballot and any accompanying materials to be sent to the members, as described in Appendix A of this part;

(7) A complete copy of the package [to be] submitted to any other regulatory agencies involved in the merger or conversion;

(8) A copy of an appraisal of the value of the credit union, if the proposal is to

convert or merge the credit union either directly or indirectly into a stock institution, and any plan for sale or distribution of stock to the credit union's members, officials and employees; and

(9) In the case of a federally-insured state chartered credit union, evidence that the state supervisory authority is in agreement with the merger or conversion proposal.

(b) *Coordination with State Supervisory Authority.*

In the event the proposal is filed with the NCUA prior to receiving consent from the state supervisory authority:

(1) The Board will coordinate with the state supervisory authority; and

(2) The Board will not approve any merger or conversion unless it is approved by the state supervisory authority.

(c) *Waiver of NCUA rules and approval by state supervisory authority.* A federally-insured state credit union may, on a case-by-case basis, request a waiver of this part 708a from the Board and receive authority to proceed under state rules and procedures. In making such a request, the credit union shall demonstrate that the concerns underlying this part 708a are adequately addressed and, in particular that:

(1) Proceeding under state rules present no financial risk to the credit union or the NCUSIF;

(2) Adequate safeguards exist against breach of duty by, or preferential treatment of directors, committee members and others involved in the transaction; and

(3) The transaction is otherwise fair to members and carried out pursuant to an informed and decisive membership vote.

§ 708a.4 Approval of Proposal by NCUA.

If NCUA finds that the proposal complies with the provisions of this part and does not present an undue risk to the NCUSIF or unduly prejudice the members, it may approve the proposal subject to such other specific requirements as may be prescribed to fulfill the stated purposes of the proposal. No proposal will be approved that does not clearly inform the members of the fundamental rights they would be giving up if their credit union converts or merges into a non credit union institution.

§ 708a.5 Approval of Proposal by Members.

(a) *Notification of members.* The members shall:

(1) Have the option of voting on the proposal either in person at a membership meeting or by mail ballot.

(2) Be given advance notice of the membership meeting in accordance with the provisions of Appendix A of this part. The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 days nor less than 14 days prior to the date for the vote. The ballot to be used for the membership vote shall be in accordance with the provisions of Appendix A of this part. The notice and ballot shall be provided to the members at the same time. If applicable, the notice and ballot shall be provided in both English as well as the native language of the majority of the members.

(3) Be made aware that the complete application and proposal are available for inspection at the credit union's branch offices during normal business hours.

(b) *Vote by members.* The proposal must be approved by the affirmative vote of a majority of the credit union's members.

(c) *Notice of Approval to members.* If the proposal for merger or conversion is approved by the membership and the NCUA Board, prompt and reasonable notice shall be given to all members.

§ 708a.6 Certification and Completion of Merger or Conversion.

(a) *Certification of vote.* The board of directors shall certify the results of the membership vote to the Regional Director within 10 days after the vote is taken.

(b) *Completion.* Upon approval of the proposal by NCUA, the state supervisory authority (where the credit union is state chartered), the members and any federal agency with approval or regulatory authority for the transaction, the credit union may complete the merger or conversion.

(c) *Certification of completion.* Within 30 days after the effective date of the merger or conversion, the board of directors of the continuing institution shall certify the completion of the transaction to the Regional Director.

(d) *Cancellation of charter and insurance.* Upon NCUA's receipt of certification that the transaction has been completed, the charter of the federal credit union (if applicable) and the insurance certificate of the federally insured credit union will be canceled.

Appendix A to Part 708a—Notice to Members of Special Meeting, Disclosure and Ballot

(1) The Notice of Special Meeting must include the following:

- (a) The date, time and place of the Meeting
- (b) A description of the matters to be voted upon at the Special Meeting;

(c) A statement in a prominent location in bold letters that "A DISCLOSURE STATEMENT HAS BEEN PROVIDED TO YOU WITH THIS NOTICE OF SPECIAL MEETING. THE DISCLOSURE MUST BE READ BEFORE VOTING ON THE PROPOSED ("CONVERSION" or "MERGER", as appropriate)", and

(d) A statement that a Mail Ballot for the Special Meeting is enclosed.

(2) The Disclosure provided with the Notice must at a minimum provide the following information to the members:

(a) Factual information about the credit union, i.e. name and address of credit union and telephone number of contact person;

(b) Summary of the proposal which shall contain but not necessarily be limited to current financial reports for the credit union and the other institution if a merger is proposed; a projected financial report for the continuing institution; analyses of share values; an explanation of any proposed share adjustments; and an explanation of any changes relative to insurance such as insurance of member accounts and life savings and loan protection insurance.

(c) Summary of the direct and indirect benefits to the credit union members, as well as any disadvantages, including a clear explanation of the nature of the change in the members' ownership interest in the reserves and undivided earnings of the credit union as a result of the merger or conversion;

(d) Summary of the direct and indirect benefits to management and other key persons at the credit union and at the new institution, including a comparison of salaries for those individuals employed by both the credit union and the new institution; copies of the certifications from the directors and committee members that they will receive no compensation either directly or indirectly from the new institution for a period of two years; and disclosure of any relationship by blood or marriage, of any of the officers, directors, key personnel or principal stockholders of the proposed institution to any officials or employees of the credit union.

(e) For each director, officer, key employee and consultant of the proposed institution, state in detail the names, positions, addresses, age and description of employment and educational background. Include any petitions for bankruptcy, civil judgments (indicate the plaintiff and the amount of the judgment), criminal conviction (indicate the nature of the charge) and any administrative action taken by a federal or state agency.

(f) Description of how the proposed merger/conversion results in a new financial institution without the unique characteristics of a credit union, for example, that the board of directors (that is, any new board members, since § 708a.2(c) prohibits compensation for a period of 2 years) may be compensated as officials instead of offering volunteer services, that the credit union will lose its tax exempt status, and any changes in the voting power of members.

(g) A dollar expenditure comparison chart of the estimated increases/decreases in regulatory and insurance fees;

(h) Itemized expenses incurred to date in the conversion process with an estimate as to future expenses;

(i) Management's discussion and analysis of the proposed conversion, including its economic advisability and how it will serve the needs of the members of the merging or converting credit union;

(j) Business and properties of the proposed institution—describe in detail the assets of the credit union and whether these assets will be transferred to the proposed institution and how the members will or will not benefit from the transfer;

(k) Description and comparison of the competition of the proposed institution and why the proposed institution believes it can effectively compete;

(l) In any transaction where the new or resulting institution is a stock institution, identify the principal owners of the proposed stock institution (those who will beneficially own directly or indirectly 1% or more of the common and preferred stock outstanding) starting with the largest common stockholder. Indicate by footnote if the price paid was for a consideration other than cash and the nature of any such consideration. Indicate the number of shares to be individually owned by officers, directors and key personnel of the new institution; and

(m) State in bold on the cover "PLEASE READ THIS DISCLOSURE DOCUMENT. IT CONTAINS IMPORTANT INFORMATION ABOUT YOUR CREDIT UNION."

(3) The Mail Ballot must:

(a) State at the top in bold letters using 12 point pitch or greater that "THE ATTACHED DISCLOSURE STATEMENT MUST BE READ BEFORE VOTING ON THE PROPOSED ("CONVERSION" or "MERGER", as appropriate);"

(b) The issues for the member to vote on should be stated as follows:

Please vote for either (a) or (b) by checking the appropriate box.

(a) Approve the merger

(b) Disapprove the merger

(c) Advise the member of the right to terminate the mail ballot and attend and vote at the Special Meeting.

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 95-ANE-02; Amendment 39-9170; AD 95-05-03]

Airworthiness Directives; Hamilton Standard 14RF Series, 14SF Series, and Hamilton Standard/British Aerospace Model 6/5500/F Propellers

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; request for comments.

SUMMARY: This amendment supersedes an existing airworthiness directive (AD), applicable to Hamilton Standard 14RF series, 14SF series, and Hamilton Standard/British Aerospace 6/5500/F series propellers, that currently requires a one-time ultrasonic shear wave inspection for cracks in the propeller blade taper bore. This amendment requires initial and repetitive ultrasonic shear wave inspections, and a one-time visual and borescope inspection of the taper bore for corrosion as a terminating action to the ultrasonic shear wave inspections. This amendment is prompted by reports of two incidents where a portion of the propeller blade was lost in flight. The actions specified by this AD are intended to prevent loss of a propeller blade due to cracks initiating in the blade taper bore, that can result in possible aircraft damage, and possible loss of aircraft control.

DATES: Effective March 23, 1995.

The incorporation by reference of the following Hamilton Standard Alert Service Bulletins (ASB) was approved by the Director of the Federal Register as of May 2, 1994: ASB's No. 14RF-9-61-A66, No. 14RF-19-61-A34, No. 14RF-21-61-A53, No. 14SF-61-A73, and No. 6/5500/F-61-A27, all dated April 18, 1994.

The incorporation by reference of all other Hamilton Standard ASB's and Service Bulletins listed in this AD is approved by the Director of the Federal Register as of March 23, 1995.

Comments for inclusion in the Rules Docket must be received on or before May 8, 1995.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), New England Region, Office of the Assistant Chief Counsel, Attention: Rules Docket No. 95-ANE-02, 12 New England Executive Park, Burlington, MA 01803-5299.

The service information referenced in this AD may be obtained from Hamilton Standard, One Hamilton Road, Windsor Locks, CT 06096-1010; telephone (203) 654-3610. This information may be examined at the FAA, New England Region, Office of the Assistant Chief Counsel, Burlington, MA; or at the Office of the Federal Register, 800 North Capitol Street NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Frank Walsh, Aerospace Engineer, Boston Aircraft Certification Office, FAA, Engine and Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803-5299; telephone (617) 238-7158, fax (617) 238-7199.

SUPPLEMENTARY INFORMATION: On April 18, 1994, the Federal Aviation

Administration (FAA) issued airworthiness directive (AD) 94-09-06, Amendment 39-8894 (59 FR 19127, April 22, 1994), applicable to Hamilton Standard 14RF series, 14SF series, and Hamilton Standard/British Aerospace 6/5500/F series propellers, to require an ultrasonic shear wave inspection of the blade taper bore for cracks, and replacement, if necessary, with a serviceable propeller blade. That action was prompted by reports of two incidents where a portion of the propeller blade was lost in flight. On March 13, 1994, an ATR-42 commuter aircraft experienced an inflight loss of the right propeller and a portion of the associated engine gearbox. Later that month, on March 30, 1994, an Embraer EMB-120 commuter aircraft also experienced an inflight loss of a portion of a propeller blade. This blade fractured at approximately the 19-inch station and the remainder of the propeller blade, propeller, and gearbox remained intact.

Subsequent metallurgical examination of these fractured blades revealed that the fracture initiated in a small cavity or pit that formed on the inner surface of the taper bore inside the aluminum blade spar. Further laboratory investigations revealed these corrosion pits may develop occasionally when chlorine residue present in the cork used to seal the inner taper bore combines with water in the presence of oxygen. That condition, if not corrected, could result in loss of a propeller blade due to cracks initiating in the blade taper bore, that can result in possible aircraft damage, and possible loss of aircraft control.

Since the issuance of that AD, the FAA has conducted engineering and laboratory investigation and analysis of world-wide inspection results received from AD 94-09-06. This data indicates that either periodic ultrasonic shear wave inspection of the propeller taper bore should be conducted every 1,250 flight cycles in service (CIS) in order to discover cracks that may initiate in pits, or a one-time visual and borescope inspection of the taper bore should be conducted after removing the propeller inner taper bore cork seal to insure that no corrosion has occurred.

The FAA has reviewed and approved the technical contents of the following Hamilton Standard Service Bulletins (SB's) and Alert Service Bulletins (ASB's):

ASB's No. 14RF-9-61-A66, No. 14RF-19-61-A34, No. 14RF-21-61-A53, No. 14SF-61-A73, and No. 6/5500/F-61-A27, all dated April 18, 1994, that describe procedures for ultrasonic shear wave inspections of the