

Proposed Rules

Federal Register

Vol. 64, No. 26

Tuesday, February 9, 1999

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

Small Business Investment Companies

AGENCY: Small Business Administration.

ACTION: Proposed rule.

SUMMARY: In order to encourage small business investment companies (SBICs) to invest in inner cities and rural areas and in businesses that serve such areas, the Small Business Administration (SBA) is proposing to introduce a new SBIC investment category called low and moderate income investments (LMI Investments). For each SBIC financing that qualifies as an LMI Investment, SBA proposes to modify its regulations on control of the small business, "cost of money" of the financing, and term of the financing. SBA is also proposing to make available a patient form of debenture leverage that could be issued only by SBICs that make LMI Investments. These incentives would apply only to LMI Investments made after the effective date of a final rule.

DATES: Comments must be submitted on or before March 11, 1999.

ADDRESSES: Written comments should be addressed to Don A. Christensen, Associate Administrator for Investment, U.S. Small Business Administration, 409 3rd Street, S.W., Suite 6300, Washington, D.C. 20416.

FOR FURTHER INFORMATION CONTACT: Saunders Miller, Investment Division, at (202) 205-3646.

SUPPLEMENTARY INFORMATION: Since its creation in 1958, the SBIC Program has proven to be an extremely effective mechanism for serving the capital needs of tens of thousands of small businesses. However, there are many eligible small businesses that have not yet been reached by either the SBIC Program or the private marketplace. Many of these businesses are located in inner cities and rural areas around the country. SBA has made a commitment to increase access to its programs, including the SBIC Program, by these businesses.

Small businesses located in inner cities and rural areas appear to have greater difficulty raising capital than small businesses located elsewhere. Explanations for this may vary, but surely include the perceived risks associated with investing in any previously untapped market. Especially when the untapped market is in an area of above-average unemployment and poverty, the perceived risks may overshadow the real opportunities.

SBA is proposing a program of narrowly-tailored regulatory and financial incentives to overcome those perceptions and to encourage SBICs to expand their investment activity into inner cities and rural areas. The incentives would be available to any SBIC making qualified investments (LMI Investments) in qualified small businesses (LMI Enterprises) that are located in or that provide employment for inner cities and rural areas (LMI Zones). The proposed incentives fall into two categories. First, SBA would allow SBICs greater regulatory flexibility when structuring and making LMI Investments. Second, SBA would make available a deferred-interest debenture exclusively for the financing of LMI Investments.

Defining Low and Moderate Income Zones (LMI Zones)

The Federal Government has already identified five different and, in some cases, overlapping geographic areas in need of special attention: (1) Historically underutilized business zones or HUBZones (as defined in 13 CFR § 126.103), (2) Urban Empowerment Zones (as designated by the Secretary of the Department of Housing and Urban Development (Sec'y-HUD)) and Rural Empowerment Zones (as designated by the Secretary of the Department of Agriculture (Sec'y-AG)), (3) Urban Enterprise Communities (as designated by the Sec'y-HUD) and Rural Enterprise Communities (as designated by the Sec'y-AG), (4) Low and Moderate Income areas (as recognized by the Federal Financial Institutions Examination Council), and (5) Persistent Poverty counties (as classified by the Economic Research Service of the Department of Agriculture). These areas share a shortage of investment capital and a critical need for job creation. These areas also conform generally to what

would be considered inner cities and rural areas. For the purposes of the SBIC Program, SBA is proposing to consolidate all of these areas into a single category to be named Low and Moderate Income Zones, or LMI Zones. A new defined term, LMI Zone, would be added.

Each of the five areas that would comprise LMI Zones has an electronic address-database associated with it. These databases are Government-operated and are accessible to the general public via the Internet. An SBIC can determine whether an address is located in an LMI Zone by going to one of the Government websites listed below and inputting the address. If the address is not in that database's defined area, the SBIC can go to the next Government website on the list. If the address is located in a HUBZone, an Empowerment Zone, an Enterprise Community, a Low or Moderate Income area, or a Persistent Poverty county, it will be considered to be located in an LMI Zone.

The Government databases for the five areas are:

1. HUBZones: www.sba.gov/hubzone/hubqual.html
2. Empowerment Zones: www.hud.gov/ezec/locator/
3. Enterprise Communities: same as for Empowerment Zones
4. Low and Moderate Income areas: www.ffiec.gov/geocode
5. Persistent Poverty counties: www.econ.ag.gov/epubs/other/typolog

SBA is exploring the possibility of consolidating these databases into a single electronic database at SBA. The final rule will contain further information on this subject.

Defining LMI Enterprise

SBA is proposing to add a new defined term, LMI Enterprise. The definition would include any eligible small business with a principal place of business in an LMI Zone at the time the business applies for SBIC financing. In addition, SBA recognizes that businesses located outside of LMI Zones can be an important source of employment for persons residing within LMI Zones. To reach these important sources of employment, the proposed definition of LMI Enterprise would also include any eligible small business, regardless of its location, that has at least 35 percent of its full time employees residing in LMI Zones at the

time the business applies for SBIC financing. The percentage requirement is based on SBA's HUBZone Program (15 U.S.C. 632(p)).

Under proposed Section 107.610(e), each LMI Enterprise would be required to certify to the investing SBIC as to the location of either its principal place of business or the primary residences of all of its full-time employees. The certification would be dated no earlier than the date the small business applies for the SBIC financing. The SBIC would keep the certification in its files, along with the SBIC's own certification that the small business qualifies as an LMI Enterprise and the basis for such qualification. To make this certification, the SBIC would have to access the electronic databases to verify that the addresses of the small business or 35 percent of its full-time employees are within an LMI Zone.

Defining LMI Investment

SBA wants to ensure that the SBIC Program is used to promote true venture capital financing in LMI Zones, not just high-interest lending. SBA is also concerned that the assets of LMI Enterprises not be placed unduly at risk as a result of receiving financing from SBICs. SBA is therefore proposing that LMI Investments be defined to include only those SBIC financings that are in the form of equity securities (as defined in § 107.800) or debt securities (as defined in § 107.815) which are subordinated to all borrowings of the business from financial institutions. As a further requirement, LMI Investments in the form of debt securities would be required to be unsecured, although the SBIC would be permitted to accept a guarantee of the debt security if the guarantee were itself unsecured. The SBIC would be an unsecured creditor of the LMI Enterprise, with all the legal remedies available to unsecured creditors.

Regulatory and Financial Incentives

From SBA's discussions with community development venture capital managers, including managers of Specialized SBICs, and from SBA's observations of SBIC and private venture activity, it appears that SBA regulations may not encourage and may actually deter investment in LMI Zones. SBA regulations do not permit some of the financing structures and protections favored by the groups currently investing in inner cities and rural areas. Furthermore, the type of SBA financial assistance available to most SBICs—the SBA guaranteed debenture—does not match well with the type of venture

capital financing that SBA wants to encourage in LMI Zones.

After careful consideration, SBA has concluded that certain of its regulations need to be modified and a more patient form of debenture needs to be created if SBICs are to be expected to actively pursue investments in LMI Zones.

1. Temporary Control of the LMI Enterprise

Many businesses located in or serving LMI Zones are at an earlier stage in their development than the businesses customarily financed by SBICs. These businesses may be perceived as having a higher degree of risk. Venture capital managers investing in inner cities and rural areas typically insist on a high degree of influence over the small business' operations. Often this takes the form of a controlling equity position in the company.

In the SBIC Program, SBICs are not permitted to assume control over a small business. Over the years, though, SBA has identified four circumstances under which temporary control over a small business may be warranted. These are set forth in current Section 107.865(d). SBA is today proposing to add a fifth circumstance to the list—the making of an LMI Investment. Under the proposal, an SBIC would be permitted to take temporary control of each business in which it makes an LMI Investment.

SBA makes this proposal with some hesitation. SBA's statutory mission is to protect small businesses. This mission must not be compromised. However, when SBA policies adopted to protect small businesses have the unintended effect of foreclosing opportunities for those businesses to grow and to modernize, SBA must reconsider its policies. If, as SBA has concluded, the regulations deter SBICs from making many LMI Investments because of the prohibition against taking control, then owners of LMI Enterprises are being denied the opportunity to choose to give up (or share) control of the business temporarily in exchange for SBIC financing. Under SBA's proposal, owners of LMI Enterprises would be given the opportunity to make that choice. It would be the small business owner, not SBA, who would decide whether the risk of losing temporary control over the business was worth the benefits of the financing. SBA recognizes the importance of this issue and encourages readers to submit comments.

Under SBA's proposal, control over the LMI Enterprise would be permitted only for the term of the financing. As discussed below, the term of an LMI

Investment may be less than the 5 years typically required for SBIC investments.

If an SBIC assumes control over an LMI Enterprise that participates in SBA's 8(a) Program or SBA's Small Disadvantaged Business Program, the LMI Enterprise will lose its eligibility for those Programs.

2. Royalties and Cost of Money

SBA is proposing to exclude royalty payments on LMI Investments from the calculation of "Cost of Money" under Section 107.855. Cost of Money is the term for the sum of the interest rate and other charges that an SBIC imposes on a small business. The Cost of Money to the small business must not exceed the SBIC's Cost of Money ceiling, as computed under Section 107.855(c).

The computation of Cost of Money already excludes certain fees, charges, and other payments made by the small business, as set forth in Section 107.855(g)(1)–(11). This proposed rule would add royalty payments under an LMI Investment as one more exclusion from Cost of Money.

To qualify for the exclusion, the royalty would have to be based on improvement in the performance of the LMI Enterprise after the date of the financing. The royalty could be expressed, for example, as a percentage of any *increase* in an underlying unit of measurement (e.g., revenues or sales) after the date of the financing.

If the SBIC accepts a royalty payment from an LMI Enterprise that is expressed as a percentage of the business' overall revenues, the royalty payment will be included in the Cost of Money calculation. If, on the other hand, the royalty is expressed as a percentage of any increase in the business' revenues after the date of the financing, the royalty payment will be excluded from the Cost of Money calculation. If an exact measurement of revenues or sales is not possible on (or even "as of") the date of the financing, the parties may use an estimate instead.

SBA believes that this proposed change is necessary to encourage SBICs to actively pursue investments in inner cities and rural areas. If adopted, this change would allow greater flexibility in structuring LMI Investments since LMI Enterprises would have the opportunity to offer royalty payments to an SBIC rather than bring the SBIC in as a new shareholder. This would result in more financing choices for the small business.

3. Minimum Term of LMI Investment

SBA is proposing a one-year minimum term for LMI Investments. As a general rule, SBIC financings must be for a minimum period of 5 years. Four

exceptions to the rule currently exist and are found in Section 107.835. SBA proposes to add LMI Investments as a fifth exception. SBA believes that this proposed change, in combination with the proposed changes discussed above, would provide the necessary encouragement for SBICs to aggressively seek out LMI Enterprises to finance.

A conforming change is being proposed to Section 107.850(a). Currently, this section prohibits the mandatory redemption of equity securities by a small business within 5 years from the date of the first closing of the financing. Under the proposed change, an SBIC could not require an LMI Enterprise to redeem an equity security LMI Investment within 1 year from the date of the first closing of the financing.

4. *Deferred Interest Debenture*

SBA recognizes that some uncertainty naturally accompanies an investor's first efforts in any previously untapped market. SBA does not want SBICs to be deterred from making those efforts in LMI Zones solely because the SBIC managers are concerned about being able to make current interest payments on SBA guaranteed debentures. SBA is prepared to allow SBICs to finance LMI Investments with a more patient-type of debenture (called an LMI Debenture in this proposed rule).

The LMI Debenture currently under consideration would be a ten-year, non-amortizing debenture issued at a discount so as to be, in effect, "zero coupon" for the first 5 years. The LMI Debenture would require semi-annual interest payments on the face amount for the last 5 years. For example, an SBIC issuing a \$100,000 debenture at a 6 percent interest rate would receive approximately \$75,000 upon issuance, and would make no interest payments for the first 5 years. Starting with the sixth year, the SBIC would make semi-annual interest payments based on an annual rate of 6 percent on the debenture's face amount of \$100,000. At maturity (or sooner in the event of prepayment), the SBIC would pay the \$100,000 face amount of the debenture. SBA leverage fees would not be deferred; they would be paid as required under current Section 107.1130.

Each SBIC that is licensed and eligible to issue debentures under current regulations would be eligible to issue LMI Debentures to the extent it makes LMI Investments. To ensure that LMI Debenture funds are used to support LMI Investments only, an SBIC's eligibility for these debentures would be limited by the amount of its outstanding

LMI Investments (made after the effective date of the final rule).

More specifically, an SBIC's eligibility for an LMI Debenture would be determined in two ways. First, the SBIC would have to be eligible to issue leverage in an amount equal to the face amount of the LMI Debenture. Eligibility for this purpose is determined under Sections 107.1120-1160. Second, the SBIC would have to have LMI Investments in an amount approximating the net proceeds of the LMI Debenture. Since the actual amount of the net proceeds of an LMI Debenture will depend on interest rates in effect at the time of its issuance and cannot be known at the time of the SBIC's leverage application, SBA is considering using a fixed multiple of 1.5 to make this second eligibility determination. An SBIC would be eligible for an LMI Debenture with a face amount equal to 1.5 times the amount of the SBIC's LMI Investments at the time of application. In the above example, the SBIC would be required to have \$66,666 of LMI Investments in its portfolio at the time the SBIC applied to issue the \$100,000 LMI Debenture.

No regulatory changes are necessary to implement this new type of debenture.

Compliance With Executive Orders 12612, 12778 and 12866, the Regulatory Flexibility Act (5 U.S.C. 601, et seq.), and the Paperwork Reduction Act (44 U.S.C. Ch. 35).

SBA certifies that this proposed rule may constitute a significant regulatory action within the meaning of Executive Order 12866, since it raises a new policy issue reflecting the President's priorities.

SBA certifies that this proposed rule does not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq. This proposed rule would change some requirements to encourage SBICs to make additional qualified investments in low and moderate income zones. In FY 1998, SBICs invested in 2700 small businesses. While the proposed rule may increase the number of small businesses receiving SBIC investments because SBICs may make investments in smaller increments, the number of small businesses eligible for SBIC investments would not change.

For purposes of the Paperwork Reduction Act, 44 U.S.C. CH. 35, SBA is requesting a modification of SBA Forms 468 and 1031 that will permit participating SBICs to report the information they are required to

maintain by the proposed rule. The proposed rule will require SBICs that make LMI Investments to keep track of their LMI Investments and periodically report them SBA. To determine whether an SBIC is making an LMI Investment, the SBIC will have to verify the location of the LMI Enterprise or its employees using the databases discussed in this proposed rule. SBA estimates that the time necessary to verify the location of an LMI enterprise or its employees will average less than one hour per LMI Investment. The reporting requirements are de minimis since current forms will only be changed to reflect LMI investments. SBA further estimates that SBICs may make approximately 500 LMI Investments per year. SBA is seeking comment on whether this information is necessary for the proper performance of the function of the agency, accuracy of burden estimate, in addition to ways to minimize this estimate, and ways to enhance the quality. Please send comments to Saunders Miller, SBA, Investment Division, 409 3rd Street, SW., Washington, DC 20416 and to David Rostker, Office of Management and Budget, Office of Information and Regulatory Affairs, 725 17th Street, NW., Washington, DC 20503.

For purposes of Executive Order 12612, SBA certifies that this rule would not have any federalism implications warranting the preparation of a Federalism Assessment.

For purposes of Executive Order 12778, SBA certifies that this rule is drafted, to the extent practicable, in accordance with the standards set forth in Section 2 of that Order.

List of Subjects in 13 CFR Part 107

Investment companies, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons set forth above, SBA proposes to amend 13 CFR part 107 as follows:

PART 107—SMALL BUSINESS INVESTMENT COMPANIES

1. The authority citation for part 107 continues to read as follows:

Authority: 15 U.S.C. 681 et seq., 683, 687(c), 687b, 687d, 687g and 687m.

2. Amend § 107.50 to add definitions of LMI Enterprise, LMI Investment, and LMI Zone, to read as follows:

§ 107.50 Definitions of terms.

* * * * *

LMI Enterprise means, at the time of application for SBIC financing, a Small Business:

(1) That has its principal place of business in an LMI Zone, or
 (2) In which at least 35 percent of the full-time employees have primary residences in LMI Zone(s).

LMI Investment means a financing of an LMI Enterprise, made after March 15, 1999, in the form of equity securities or debt securities that are subordinated to all other borrowings of the business from financial institutions. The debt securities may be guaranteed, but neither the debt securities nor the guarantee may be collateralized or otherwise secured.

LMI Zone means any area located within a HUBZone (as defined in § 126.103 of this chapter), an Urban Empowerment Zone or Urban Enterprise Community (as designated by the Secretary of the Department of Housing and Urban Development), a Rural Empowerment Zone or Rural Enterprise Community (as designated by the Secretary of the Department of Agriculture), an area of Low Income or Moderate Income (as recognized by the Federal Financial Institutions Examination Council), or a county with Persistent Poverty (as classified by the Economic Research Service of the Department of Agriculture).

* * * * *
 3. Amend § 107.610 to add paragraph (e) to read as follows:

§ 107.610 Required certifications for Loans and Investments.

* * * * *

(e) For each LMI Investment:

(1) A certification by the concern as to its principal place of business or the principal residences of its full-time employees, as applicable, dated no earlier than the date of application for SBIC financing, and

(2) A certification by the SBIC that the concern qualifies as an LMI Enterprise as of the date of the concern's certification and the basis for such qualification.

4.-5. Amend § 107.835 to redesignate paragraph (d) as paragraph (e) and add paragraph (d) to read as follows:

§ 107.835 Exceptions to minimum duration/term of Financing.

* * * * *

(d) An LMI Investment with a term of at least one year; or

* * * * *

6. Amend § 107.850 to revise the introductory text of paragraph (a) to read as follows:

§ 107.850 Restrictions on redemption of Equity Securities.

(a) A Portfolio Concern cannot be required to redeem Equity Securities

earlier than 5 years (or 1 year in the case of an LMI Investment) from the date of the first closing unless:

* * * * *

7. Amend § 107.855 to add paragraph (g)(12) to read as follows:

§ 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses ("Cost of Money").

* * * * *

(g) * * *

(12) Royalty payments received under any LMI Investment if the royalty is based on improvement in the performance of the Small Business after the date of the financing.

* * * * *

8. Amend § 107.865 to remove the "or" at the end of paragraph (d)(3), replace the period at the end of paragraph (d)(4) with "; or", add paragraph (d)(5) and revise paragraph (e)(3) to read as follows:

§ 107.865 Restrictions on Control of a Small Business by a Licensee.

* * * * *

(d) * * *

(5) If your financing of the Small Business is an LMI Investment.

(e) * * *

(3) Your agreement to relinquish Control within 5 years (although you may, under extraordinary circumstances, request SBA's approval of an extension beyond 5 years). In the case of an LMI Investment with a term of less than 5 years, you must agree to relinquish Control within the term of the financing.

* * * * *

Dated: January 13, 1999.

Aida Alvarez,
Administrator.

[FR Doc. 99-2915 Filed 2-8-99; 8:45 am]

BILLING CODE 8025-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 98-NM-340-AD]

RIN 2120-AA64

Airworthiness Directives; McDonnell Douglas Model MD-90-30 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes the adoption of a new airworthiness

directive (AD) that is applicable to certain McDonnell Douglas Model MD-90-30 series airplanes. This proposal would require a one-time inspection to measure clearance and detect interference between the elevator cable pulley and the shroud frame of the ventral stairway, and modification of the shroud frame of the ventral stairway. This proposal is prompted by reports of pitch oscillation of several Model MD-90-30 series airplanes. The actions specified by the proposed AD are intended to prevent interference between the elevator cable pulley and the shroud frame of the ventral stairway, which could result in pitch oscillation of the airplane, and consequent damage to the elevator cable pulley and reduced controllability of the airplane.

DATES: Comments must be received by March 26, 1999.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM-114, Attention: Rules Docket No. 98-NM-340-AD, 1601 Lind Avenue, SW., Renton, Washington 98055-4056. Comments may be inspected at this location between 9:00 a.m. and 3:00 p.m., Monday through Friday, except Federal holidays.

The service information referenced in the proposed rule may be obtained from Boeing Commercial Airplane Group, Long Beach Division, 3855 Lakewood Boulevard, Long Beach, California 90846, Attention: Technical Publications Business Administration, Dept. C1-L51 (2-60). This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Transport Airplane Directorate, Los Angeles Aircraft Certification Office, 3960 Paramount Boulevard, Lakewood, California.

FOR FURTHER INFORMATION CONTACT: Jon Mowery, Aerospace Engineer, Airframe Branch, ANM-120L, FAA, Transport Airplane Directorate, Los Angeles Aircraft Certification Office, 3960 Paramount Boulevard, Lakewood, California 90712-4137; telephone (562) 627-5322; fax (562) 627-5210.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of the proposed rule by submitting such written data, views, or arguments as they may desire. Communications shall identify the Rules Docket number and be submitted in triplicate to the address specified above. All communications received on or before the closing date