



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #299
January 1999

December 17, 1998

Kenneth H. Suelthaus, Esquire
Suelthaus & Walsh, P.C.
7733 Forsyth Boulevard, Twelfth Floor
St. Louis, MO 63105

Re:

The First National Bank of the Mid-South, Sikeston, Missouri ("Bank")
Application Control Number: 98-MW-12-156

Dear Mr. Suelthaus:

This responds to the Bank's application under 12 C.F.R. § 5.46 to elect the corporate governance provisions of Missouri law and complete a reverse stock split in accordance with those provisions. Based on the representations and commitments made by the Bank, the proposed application is hereby approved, subject to the conditions set forth below.

Background

The Bank proposes to amend its bylaws to elect the corporate governance provisions of Missouri law, and proposes to engage in a reverse stock split as provided by Missouri law. The Bank proposes the reverse stock split to enable the Bank and its holding company, Continental Bancorporation, Inc. ("holding company") to convert to Subchapter S status. The Bank believes that the reverse stock split would substantially reduce the administrative expenses and simplify corporate procedures of the Bank.

The Bank proposes to conduct the reverse stock split through a multi-step process. First, the Bank intends to decrease the par value of its shares from \$2 to \$0.0045 to ensure that the reverse stock split complies with the \$100 legal limitation on par value of common stock contained in 12 U.S.C. § 52. That reduction in par will reduce the Bank's common stock account from \$800,000 (400,000 shares at \$2 par) to \$1800 (400,000 shares at \$0.0045 par). The Bank will transfer the amount "in excess of par," \$798,200, from the common stock account to a temporary account designated "capital over par" that would be used to meet the

Bank's statutory minimum capital requirement.¹ Then the Bank will complete a reverse stock split at a ratio of 21,056.33:1 and increase par value to \$100. The Bank will pay book value, which it believes to be fair value, for fractional shares. The Bank will then issue 7,982 shares to the holding company as a stock dividend, raising capital stock to \$800,000 by returning the funds in the "capital over par" account to the capital stock account. After the reverse stock split, the holding company will hold all of the 8,000 outstanding shares of the Bank's stock.

Applicable Law

National banks may adopt corporate governance procedures that comply with applicable federal banking law and safe and sound banking practices. An OCC regulation provides that:

To the extent not inconsistent with applicable Federal banking statutes or regulations, or bank safety and soundness, a national bank may elect to follow the corporate governance procedures of the law of the state in which the main office of the bank is located, the law of the state in which the holding company of the bank is incorporated, the Delaware General Corporation Law, Del. Code Ann. Tit. 8 (1991, as amended 1994, and as amended thereafter), or the Model Business Corporation Act (1984, as amended 1994, and as amended thereafter). A national bank shall designate in its bylaws the body of law selected for its corporate governance procedures.²

You have represented that Missouri law authorizes corporations to effect reverse stock splits. Missouri law expressly provides for dissenters' rights in mergers and consolidations, but not in reverse stock splits.³ You have represented that the Bank has agreed to provide the dissenters' rights provided in Missouri Ann. Stat. § 351.455 and to pay the costs of any resulting appraisal. You have also represented that the Bank will provide for binding arbitration if a court declines to accept jurisdiction of any action for appraisal.

The National Bank Act does not specifically address the authority of a national bank to effect a reverse stock split. Several sections of the National Bank Act, however, specifically provide for certain aspects of reverse stock splits and, when read together, permit those transactions. Section 59 permits a national bank to reduce its capital upon the vote of shareholders holding two-thirds of its capital stock and OCC approval.⁴ A national bank may engage in a number

¹See 12 U.S.C. § 51.

²12 C.F.R. § 7.2000(b).

³Mo. Ann. Stat. § 351.455 (Vernon 1991).

⁴12 U.S.C. § 59. The proposed reduction in capital as part of the reverse stock split would be approved by more than two-thirds of the Bank's shareholders since the holding

of corporate combinations, including mergers and consolidations, but it must provide dissenters' rights.⁵ Section 83 generally prohibits a national bank from purchasing, or making a loan secured by, its own stock.⁶ The OCC has interpreted section 83, however, to allow national banks to hold treasury stock for legitimate corporate purposes, after obtaining OCC approval pursuant to 12 U.S.C. § 59.⁷

The OCC routinely had approved national bank reverse stock splits until 1990,⁸ when the Court of Appeals for the Seventh Circuit concluded that a national bank's reverse stock split plan violated 12 U.S.C. §§ 83 and 214a-215a.⁹ The OCC had approved the bank's plan to use a reverse stock split to freeze-out minority shareholders and become a wholly owned subsidiary of its majority shareholder holding company. The bank proposed to pay its minority shareholders less than 50% of the stock's fair value and did not provide shareholders dissenters' rights. The court based its decision in large part on the fact that the bank's proposed cash payment to the minority shareholders was below the fair value of the stock and dissenting shareholder rights were not provided.

company controls more than 95 percent of the Bank's common stock.

⁵12 U.S.C. §§ 214a-215a.

⁶12 U.S.C. § 83.

⁷See 12 C.F.R. § 7.2020 and Interpretive Letter No. 660, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,608 (Dec. 10, 1994).

⁸The OCC formerly allowed national banks to effect reverse stock splits that complied fully with applicable law. See Interpretive Letter No. 275, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,439 (Oct. 21, 1983). On occasion, national banks effecting reverse stock splits would find it necessary to raise their stock's par value in excess of the statutory limit of \$100 per share. See 12 U.S.C. § 52. National banks can comply with section 52 requirements by establishing a temporary account designated "capital over par." See Interpretive Letter No. 313, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,483 (Oct. 22, 1984). The OCC stated in Interpretive Letter No. 313 that a "capital over par" account exists only temporarily, until newly issued stock is purchased following the reverse stock split. Once the split occurs, the "capital over par" account no longer functions as a capital account and can be counted only as surplus. In this instance, the Bank will comply with Interpretive Letter No. 313 because the "capital over par" account will no longer exist once the transaction is completed and those funds will be transferred to the Bank's capital stock account.

⁹See *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990).

The court below had held that the bank's plan violated section 83, which prohibits national banks from purchasing or making loans secured by their own stock.¹⁰ The court rejected the OCC's argument that section 59, which permits a national bank to remit cash to shareholders for the purpose of reducing its capital, took precedence over section 83 and authorized the bank's plan. The court found that the only purpose of the bank's plan was the elimination of minority shareholders and not a reduction in capital in accordance with section 59.

The court below also found that Congress and the OCC permitted national banks to use sections 214a, 215, and 215a to become wholly owned subsidiaries of holding companies. The proposed reverse stock split, while not technically a merger or consolidation, was the same type of transaction for which Congress had enacted dissenters' rights provisions in sections 214a, 215, and 215a to protect minority shareholders. The court concluded that the bank's attempt to structure a transaction to avoid dissenters' rights provisions was "contrary to the clear intent of Congress."¹¹ Because the National Bank Act provides explicit authority for freeze-outs only in sections 214a through 215a, and the Bloomington transaction failed to provide dissenters' rights available under those statutory provisions, the court found that the transaction violated those provisions.

The Seventh Circuit also found that the proposed reverse stock split violated 12 U.S.C. §§ 83 and 214a-215a, after concluding that the transaction had no legitimate business purpose and failed to provide for dissenters' rights. The Seventh Circuit expressly declined to answer whether section 83 prohibits all reverse stock split freeze-outs, noting that its opinion was limited to the facts of the case.¹²

More recently, two other courts have considered whether the National Bank Act authorized the OCC to approve transactions in which national banks sought to cash out minority shareholders. The Court of Appeals for the Eleventh Circuit found in *Lewis v. Clark* that the OCC lacked the authority to approve bank mergers that required minority shareholders to accept cash for their shares while majority shareholders were eligible to receive stock in the resulting bank, even in cases where the minority shareholders had appraisal rights.¹³ Most recently, the Court of Appeals for the Eighth Circuit distinguished *Lewis v. Clark* and found that a national bank could cash out minority shareholders, consistent with the National Bank Act, as long as there

¹⁰See *Bloomington Nat'l Bank v. Telfer*, 699 F. Supp. 190 (S.D. Ind. 1988).

¹¹*Id.* at 194.

¹²*Bloomington*, 916 F.2d at 1308 n.4, 1309.

¹³*Lewis v. Clark*, 911 F.2d 1558 (11th Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991).

is a valid business purpose for the transaction and the minority shareholders are entitled to dissenters' rights.¹⁴

A bank's decision to reduce the number of its shareholders to qualify for Subchapter S status is the type of business purpose courts have viewed as legitimizing reverse stock split transactions.¹⁵ Reducing corporate expenses and simplifying corporate procedures are also legitimate business purposes.¹⁶

The OCC has concluded that national banks may effect reverse stock splits provided that there exists a legitimate business purpose for the transaction and banks provide dissenters' rights.¹⁷ In those letters, the banks cited as their legitimate business purposes the intention to elect Subchapter S corporation status and reduce costs associated with conducting shareholders meetings.

Discussion

The Bank may adopt Missouri corporate governance procedures, to the extent that those procedures are not inconsistent with applicable Federal banking statutes or regulations. OCC regulation expressly permits a national bank to elect the corporate governance procedures of the law of the state in which the main office of the bank is located.¹⁸ Because the main office of the Bank is located in Missouri, the Bank may elect Missouri corporate governance procedures.

Missouri laws allowing for reverse stock splits are not inconsistent with applicable Federal banking statutes or regulations. No provision of Federal law expressly prohibits reverse stock splits. Several provisions of the National Bank Act authorize the elements of a reverse stock split and, when read together, allow a national bank to engage in a reverse stock split for a legitimate corporate purpose if the bank provides dissenting shareholder rights.¹⁹

¹⁴*NoDak Bancorporation v. Clarke*, 998 F.2d 1416 (8th Cir. 1993).

¹⁵*See Leader v. Hycor, Inc.*, 479 N.E.2d 173 (Mass. 1985); *Teschner v. Chicago Title & Trust Co.*, 322 N.E.2d 54 (Ill. 1974).

¹⁶*See Teschner*, 322 N.E.2d at 54.

¹⁷*See* Interpretive Letter No. 786, *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-213 (June 9, 1997); Corporate Decision No. 97-50 (June 20, 1997).

¹⁸12 C.F.R. § 7.2000(b).

¹⁹*See* Interpretive Letter No. 275, *supra*.

After reducing the par value of the Bank's shares to ensure compliance with 12 U.S.C. § 52, the Bank proposes to amend its articles of association to decrease the number of authorized shares of common stock and to increase the par value of each share. Banks may amend their articles of association by the vote of the holders of a majority of the voting shares of stock to determine the number and par value of bank shares.²⁰

The Bank then proposes to replace each of the currently outstanding shares of common stock with new common stock at the rate of one share of new common stock for each 21,056.33 shares of currently outstanding common stock. The Bank would pay cash for any fractional shares outstanding. National banks have express authority to pay the cash equivalent of fractional shares of stock.²¹ The cash equivalent must be based on the market value of the stock or, if no market exists, a reliable and disinterested determination as to the fair market value of the stock.²²

Although 12 U.S.C. § 83 generally prohibits a national bank from purchasing its own stock, this prohibition is not absolute. Section 83 was enacted to prevent a national bank from impairing its own capital, and risking injury to creditors in the event of insolvency, by purchasing and holding its own capital stock.²³ The OCC has interpreted section 83 to permit a national bank's ownership of its own stock as long as a legitimate corporate purpose for the ownership exists.²⁴

Judicial authority also provides support for concluding that reverse stock splits for legitimate business purposes can be consistent with the National Bank Act. In *NoDak*, the Eighth Circuit held that national banks could effect freeze-out mergers to allow a holding company to obtain 100 percent ownership so long as the national bank has a valid corporate purpose and observes dissenters' rights. The *NoDak Bancorporation v. Clarke* court found that a national bank may engage in any merger not inconsistent with sections 214a, 215, and 215a and that freeze-out

²⁰See 12 U.S.C. § 21a; see also 12 U.S.C. § 52 (par value may not exceed \$100 per share).

²¹12 C.F.R. § 5.67(c).

²²*Id.*

²³Letter from Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division (March 27, 1992) (unpublished).

²⁴See 12 C.F.R. § 7.2020; Interpretive Letter No. 786, *supra*; Interpretive Letter No. 660, *supra*.

mergers are not inconsistent with those sections.²⁵ Thus, applicable statutory provisions and certain judicial precedent would permit reverse stock splits for legitimate business purposes, provided dissenters' rights are available.

The Bank has articulated legitimate business purposes in effecting a reverse stock split. The Bank and its holding company wish to become Subchapter S corporations. Qualification for Subchapter S status requires obtaining unanimous shareholder approval as well as achieving the required maximum number of shareholders.²⁶ Accordingly, the Bank can pursue the reverse stock split in order ultimately to obtain unanimous shareholder approval for reorganizing as a Subchapter S corporation. In addition, the holding company may become a Subchapter S corporation only if it holds 100 percent of the stock of the Bank.²⁷ Eliminating the responsibilities associated with a substantial shareholder base is a proper business purpose.²⁸ It also is a valid business purpose to effect a merger in order to reduce corporate expenses associated with shareholder communications and meetings.²⁹

To avoid undermining the purposes of 12 U.S.C. §§ 214a, 215, and 215a, however, a reverse stock split must provide shareholders reasonable dissenters' rights to ensure that they receive a fair price for their shares. Those dissenters' rights need not be identical to those located in sections 214a, 215, and 215a. Accordingly, the Bank may effect a reverse stock split as long as it has a valid corporate purpose for the transaction and observes appropriate dissenters' rights.³⁰

²⁵*NoDak*, 998 F.2d at 1419-20, 1425. Although the Eleventh Circuit in *Lewis* held that national banks may not effect freeze-out mergers that require holders of stock of equal standing to take different forms of consideration, this is a minority view. The Seventh Circuit in *Bloomington* declined to determine if reverse stock splits would be permissible for valid business purposes if dissenting shareholders' rights were provided.

²⁶See 26 U.S.C. §§ 1361(b)(1)(A) and 1362(a)(2).

²⁷26 U.S.C. § 1361(b)(3)(B)(i).

²⁸*Leader*, 479 N.E.2d at 178.

²⁹*Teschner*, 322 N.E.2d at 58.

³⁰Missouri law neither requires nor prohibits corporations from providing shareholders with advance notice of the right to dissent. Advance notice of dissenters' rights is important to allow minority shareholders to decide whether to exercise dissenters' rights. However, the Bank intends to provide shareholders with advance notice and a copy of the statute governing dissenters' rights.

Although Missouri law does not provide for dissenters' rights in reverse stock splits, the Bank has agreed to provide dissenters' rights under Missouri law that are comparable to those under the National Bank Act.³¹ Because Missouri law does not provide for dissenters' rights in reverse stock split transactions, a Missouri court might decline to hear any resulting appraisal action that may arise. However, the Bank has agreed to provide for binding arbitration if the court declines jurisdiction. Thus, dissenting shareholders (if any) will have access to a forum for the impartial valuation of their shares.

Conclusion

For the above reasons, including the representations and commitments made by the applicant, we find that the reverse stock split application is legally authorized and meets the other statutory criteria for approval. Accordingly, this application is hereby approved, subject to the following conditions:

1. The Bank will elect the corporate governance provisions of Missouri law.
2. Notwithstanding the corporate governance provisions of Missouri law, the Bank will provide for dissenters' rights comparable to those rights available in 12 U.S.C. § 214a-215a.

³¹Under the National Bank Act, a dissenting shareholder must either vote against the merger, or give written notice of dissent prior to or at the shareholder meeting at which the shareholders vote on the merger. The value of the dissenting shareholder's shares is determined by an appraisal made by a committee of three persons: one chosen by the dissenting shareholders, one chosen by the directors of the bank (as it exists after the merger), and one chosen by the other two members of the committee. If the committee fails to determine a value of the shares, or a dissenting shareholder is not satisfied with the value determined, the OCC must make an appraisal of the shares. 12 U.S.C. §§ 214a(b), 215(b)-(d), and 215a(b)-(d). Under Missouri law, a dissenting shareholder must file a written objection to the merger or consolidation prior to the shareholder meeting and may not vote in favor of the action. Within 20 days after the effective date of the merger or consolidation, the shareholder must make a written demand on the corporation for fair value of the shares. If the dissenting shareholder and the corporation cannot agree on the fair value of the shares within 30 days after the effective date of the merger or consolidation, the dissenting shareholder may, within 60 days after the 30-day period expires, file a petition for appraisal in the appropriate state court. See Mo. Ann. Stat. § 351.455.

Both statutory schemes provide mechanisms whereby a nonvoting shareholder may dissent and receive payment for the shares. Under both provisions of law, a minority shareholder in a reverse stock split has the right to dissent and receive fair value for the shares. If the parties are unable to settle on the fair value of the shares, a state court (under Missouri law) or the Comptroller (under the National Bank Act) ultimately determines the fair value of the shares.

3. If any shareholders dissent from the reverse stock split, the Bank will pay the cost of any appraisal that may occur.

4. If the appropriate court(s) decline to accept jurisdiction of an appraisal action, the Bank will provide for binding arbitration to conduct an appraisal.

Please be advised that the above conditions of this approval shall be deemed to be conditions “imposed in writing by the agency in connection with the granting of any application or other request” within the meaning of 12 U.S.C. § 1818(b)(1).

Please notify the OCC when the change in capital has been completed in accordance with this approval. The notification should state the date of the change, the dollar amount of the reduction in the common stock and surplus account associated with the payment for fractional shares, and the dollar amount of the increase in those accounts associated with the re-issuance of shares to the holding company. The notification should include a certification that shareholders approved the change in capital structure according to law, regulations, and the Bank's Articles of Association. A secretary's certificate of shareholder approval and a certified copy of the amendment to the Articles of Association should be included. The notification should also include a statement that the change in the capital structure complies fully with all applicable laws and regulations. Upon receipt of the notification, the OCC will review the reduction in capital attributable to the payment for the fractional shares and the subsequent increase in capital attributable to the re-issuance of shares to the holding company.

The reverse stock split should be completed within one year of the date of this letter. If you have any questions, please contact Frederick Petrick, Senior Attorney, Securities and Corporate Practices Division at 202-874-5210, John Graetz, Licensing Expert (Financial Analyst), Bank Organization and Structure at 202-874-5060, or Jill Kennard, Senior Corporate Analyst, Midwestern District, at 816-556-1860.

Sincerely,

/s/

Julie L. Williams
Chief Counsel