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Comptroller of the Currency  
Administrator of National Banks

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Washington, D.C. 20219

April 1, 1999

**Corporate Decision #99-10  
May 1999**

Mr. Kevin J. Dostal  
Hansen, Engles & Locher, P.C.  
800 Exchange Building  
1905 Harney Street  
Omaha, Nebraska 68102-2314

Re: Midstates Bank, National Association  
Harlan, Iowa ("Bank")      Application Control Number: 99-MW-12-0044

Dear Mr. Dostal:

This responds to the Bank's application under 12 C.F.R. § 5.46 to elect the corporate governance provisions of Iowa 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.

**Background**

The Bank proposes to elect the corporate governance provisions of Iowa law through amendments to its articles of association ("articles") and bylaws,<sup>1</sup> and engage in a reverse stock split as provided by Iowa law. Following these amendments, the Bank proposes to convert to a Subchapter S corporation.<sup>2</sup> The Bank believes the benefits would be substantial and would include reducing its expenses in conducting shareholder meetings and providing disclosures to minority shareholders.

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<sup>1</sup>The Bank's shareholders would approve an amendment to the articles that would elect Iowa corporate governance law in accordance with 12 U.S.C. § 21a, and the board of directors would adopt similar provisions in the bylaws.

<sup>2</sup>The activity in which the Bank proposes to engage is substantially similar to that approved by the OCC in Interpretive Letter No. 786, *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-213 (June 9, 1997) ("Interpretive Letter No. 786").

The Bank desires to reduce the number of its shareholders in order to be able to attain Subchapter S status. Accordingly, it would conduct the reverse stock split to increase Midstates Bancshares, Inc.'s ("Holding Company") ownership to 100 percent of the shares.

The Bank proposes first to decrease the par value of its shares, so that at all stages of the reverse stock split the par value would remain under \$100 per share. The Bank would then replace its outstanding common stock with new shares of common stock at a rate of 15 to 1. As a result, all shareholders other than the Holding Company would own less than one share of the Bank's stock. The Bank would then pay cash to shareholders for fractional shares.<sup>3</sup>

### **Applicable Law**

National banks may adopt corporate governance procedures that comply with applicable federal banking law and safe and sound banking practices. OCC regulations provide 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.

12 C.F.R. § 7.2000(b).

Iowa statutory law expressly permits state banks to conduct reverse stock splits. Iowa Code § 524.1509 (1991). Iowa statutes also contain provisions governing reverse stock split transactions. *See id.* at §§ 490.1302(d)(5) (dissenters' rights for shareholders whose interests are reduced to fractional shares that are acquired for cash), 502.102(f)(2) (stock splits other than reverse stock splits are not offers or sales of securities), 502.203(13) (reverse stock splits exempt from registration and filing requirements of state securities law), and 502.214 (limitations on takeover offers within two years after any of a number of listed transactions, including reverse stock splits).

### **Discussion**

The Bank may adopt Iowa 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

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<sup>3</sup>If a shareholder dissents and is dissatisfied with the payment offered by the Bank, the Bank, through its counsel, has represented that the Bank will incur the cost of the appraisal, as provided by Iowa law.

state in which the main office of the bank is located. 12 C.F.R. § 7.2000(b). Because the main office of the Bank is located in Iowa, the Bank may elect Iowa corporate governance procedures.

Iowa law allowing reverse stock splits is 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 dissenting shareholder rights are provided. *See also* Interpretive Letters Nos. 786 and 660.

To effect the first element of the reverse stock split, the Bank proposes to amend its articles to decrease the number of authorized shares of common stock and to increase the par value of each share. Banks may amend their articles 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. *See* 12 U.S.C. § 21a; *see also* 12 U.S.C. § 52 (par value may not exceed \$100 per share).

To effect the second element of a reverse stock split, the Bank proposes to replace each of the currently outstanding common stock with new common stock at the rate of one share of new common stock for each 15 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. 12 C.F.R. § 5.67(c). 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. *Id.*

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. Letter from Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division (March 27, 1992) (unpublished). 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. *See* 12 C.F.R. § 7.2020 and Interpretive Letter No. 660, *supra*.

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* court found that a national bank may engage in any merger not inconsistent with sections 214a, 215, and 215a, and that freeze-out mergers are not inconsistent with those sections. *NoDak, supra*, 998 F.2d at 1419-20, 1425.<sup>4</sup> Thus, applicable statutory

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<sup>4</sup>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.

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. Because it is now owned by both the Holding Company and individual shareholders, the Bank does not currently qualify for Subchapter S status. A Subchapter S corporation may be wholly (but not partially) owned by another Subchapter S corporation, but may not be owned (wholly or partially) by a corporation other than a Subchapter S corporation. See 26 U.S.C. §§ 1361(b)(1), (3). The Bank, then, cannot elect to become a Subchapter S corporation unless the Holding Company: (1) owns 100 percent of the Bank's stock; and (2) becomes a Subchapter S corporation. Accordingly, the Bank must pursue the reverse stock split in order ultimately to become a Subchapter S corporation. Eliminating burdens associated with a large shareholder constituency is a proper business purpose. *Leader, supra*, 479 N.E.2d at 178. It also is a valid business purpose to effect a merger in order to reduce corporate expenses associated with shareholder communications and meetings. *Teschner, supra*, 322 N.E.2d at 58.

To avoid undermining the purposes of 12 U.S.C. §§ 214, 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.

Iowa law governing reverse stock splits provides minority shareholders with dissenters' rights.<sup>5</sup> Iowa Code § 490.1302(1)(d)(5) (1991). Banks must include notice of dissenters' rights with the notice for the meeting at which the shareholders will vote on the reverse stock split. *Id.* at § 490.1320. Any shareholder who wishes to dissent must give notice to the bank of intent to dissent and may not vote in favor of the reverse stock split at the shareholders' meeting. *Id.* at § 490.1321. After the meeting, the bank must send written notice to all dissenters concerning the procedure for demanding payment. *Id.* at § 490.1322. Dissenting shareholders must then demand payment, and the bank must make payment to the shareholders. *Id.* at §§ 490.1323, 490.1325. Any shareholder who is dissatisfied with the payment offered must provide the bank with an estimate of fair value. *Id.* at § 490.1328. The bank must then either pay the amount requested by the shareholder, or seek an appraisal from the court. *Id.* at § 490.1330. In an appraisal proceeding, the bank is presumed to pay costs, but the court may assess the costs to the

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<sup>5</sup>Similarly, the National Bank Act provides for dissenters' rights. 12 U.S.C. §§ 214a(b), 215(b)-(d), and 215a(b)-(d). 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.

shareholders if the court finds that the shareholders were arbitrary, vexatious, or not in good faith. *Id.* at § 490.1331.

The dissenters' rights for Bank shareholders under Iowa law afford comparable protections to the dissenters' rights provisions in the National Bank Act. 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.<sup>6</sup> The corporation makes the first offer of fair value, and minority shareholders may accept the offer or make a counteroffer. If the parties are unable to settle on the fair value of the shares, a state court (under Iowa law) or the Comptroller (under the National Bank Act) ultimately determines the fair value of the shares. As with Federal law, the law in Iowa provides that the Bank will incur the cost of the appraisal used to determine the fair value of the shares, unless the court determines that the shareholders were arbitrary, vexatious, or did not act in good faith.

## **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. 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.

The reverse stock split should be completed within one year of the date of this letter. If you have any questions concerning this letter, please contact John C. Morgan, Senior Attorney, Midwestern District, at 816-556-1870.

Sincerely,

/s/

Julie L. Williams  
Chief Counsel

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<sup>6</sup>The National Bank Act requires dissenting shareholders either to give written notice of dissent, or to vote against the merger. Iowa law requires dissenting shareholders both to give written notice of dissent, and not to vote in favor of the merger. This difference is not material because both codes provide a mechanism whereby a nonvoting shareholder may still dissent and receive payment for the shares.