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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

**Corporate Decision #2002-08**  
**June 2002**

May 15, 2002

J. David Stanford, Esq.  
P.O. Box 1145  
80 South Main  
Salado, Texas 76571

Subject: Application to Conduct a Share Exchange by First National Bank of Midland,  
Midland, Texas.; Control No. 2002-SW-12-0015

Dear Mr. Stanford:

This is to inform you that on May 14, 2002 the Office of the Comptroller of the Currency (OCC) approved your proposal to undertake an ownership restructuring of the Bank pursuant to the provisions of 12 U.S.C. § 215a-2<sup>1</sup> and 12 C.F.R § 7.2000. In this restructuring, the Bank is effecting a share exchange to become a subsidiary of a holding company. The share exchange offers most shareholders holding company stock for their bank shares. It, however, provides out-of-state residents cash for their bank shares so that the holding company may avoid costs associated with registering its stock under the Securities Act of 1933.

## **I. Facts**

The Bank is reorganizing into a subsidiary of a de novo bank holding company through a share exchange. The Bank will exchange one share of its holding company's stock for each share of Bank stock of Texas residents. The Bank will pay \$2.75 in cash for each share of Bank stock of six non-Texas residents. Bank counsel represents that the cash price for minority shareholders is fair because it exceeds the Bank's per share book value of approximately \$ 2.00.<sup>2</sup> The Bank will cash out the minority to take advantage of the intrastate offering exemption from registration under section 3 of the Securities Act of 1933 and avoid the costs associated with registration. No shareholders voted against the transaction at the shareholder meeting held April 16, 2002.

## **II. Discussion**

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<sup>1</sup> Section 1204 of the American Home Ownership and Economic Opportunity Act of 2000, 114 Stat. 2944, Pub. L. No. 106-569, 106<sup>th</sup> Cong. (2000), codified at 12 U.S.C. § 215a-2.

<sup>2</sup> The Bank in its proxy statement discloses that there have been 19 recorded transactions in the Bank's stock since first quarter 2000, and all of those have occurred at a price of \$2.75 per share.

A national bank may use a share exchange to effect a reorganization or to form a de novo holding company under section 215a-2. Section 215a-2 requires the bank's reorganization plan to specify the manner of the exchange, be approved by both the shareholders and the board of directors, state the consideration to be paid for bank shares (e.g., cash, holding company securities, or a combination of both), and provide dissenters' rights to all shareholders.

Under section 215a-2, a bank may pay shareholders different forms of consideration in an exchange. The language of section 215a-2 and its brief legislative history do not address or restrict the ability of national banks to offer different types of consideration in a share exchange. The legislative history explains that section 215a-2 amends the National Bank Consolidation and Merger Act to prescribe "expedited procedures" permitting a national bank to reorganize.<sup>3</sup> In this case, providing different types of consideration facilitates the share exchange transaction and, therefore, is consistent with congressional intent in enacting section 215a-2.

Courts have not yet considered whether section 215a-2 permits a national bank to pay different forms of consideration in a share exchange. Case law holding national banks may offer different consideration in other types of reorganizations provides support for finding that differing types of consideration may be paid in this case. The Court of Appeals for the Eighth Circuit, in *NoDak Bancorporation v. Clarke*,<sup>4</sup> held that a national bank may use differing forms of consideration to cash out minority shareholders in a freeze-out merger.<sup>5</sup> The court found that the transaction was not inconsistent with the National Bank Act, as long as minority shareholders receive dissenters' rights.<sup>6</sup> The court reviewed the legislative history of the National Bank Act and found that freeze-out mergers were consistent with Congress' intent to simplify and encourage national bank consolidations.<sup>7</sup> More recently, a district court in the Tenth Circuit relied on *NoDak* to hold that a bank may effect a freeze-out merger to consolidate with another bank and become a wholly owned subsidiary of an existing bank holding company.<sup>8</sup>

The Seventh Circuit, in *Bloomington Nat'l Bank v. Telfer*,<sup>9</sup> reviewed reverse stock splits, which also involve differing forms of consideration. There, the court found that a proposed transaction violated 12 U.S.C. §§ 83 and 214a-215a. The court held that a national bank must have a legitimate corporate purpose to freeze-out some, but not all shareholders and repurchase its stock without violating section 83. The court invalidated the transaction it was reviewing for the bank's failure to articulate a legitimate business purpose and to provide for dissenters' rights. The court, however, expressly limited its opinion to the facts of the case, leaving open the

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<sup>3</sup> Bill summary accompanying Pub. L. No. 105-569 (available at <http://thomas.loc.gov/cgi-bin/bdquery/D?d106:l:/temp/~bdYeXJ:@@L&summ2=m&/bss/d106query.html>). See also Speech of the Hon. James A. Leach in the House of Representatives (Oct. 24, 2000), 147 Cong. Rec. E1924 (Oct. 25, 2000).

<sup>4</sup> *NoDak Bancorporation v. Clarke*, 998 F.2d 1416, 1425 (8th Cir. 1993) ("*NoDak*").

<sup>5</sup> *But cf. Lewis v. Clark[e]*, 911 F.2d 1558 (11th Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991) ("*Lewis*") (expressing the minority view that reverse stock splits are not permitted for national banks because the National Bank Act does not expressly provide for cash-outs of minority shareholders).

<sup>6</sup> 998 F.2d at 1422.

<sup>7</sup> *Id.*

<sup>8</sup> *Moody v. First National Bank, Sallisaw*, CV-00-306-5 (E.D. Ok. July 5, 2001).

<sup>9</sup> *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990) ("*Bloomington*").

possibility that a national bank may effect a reverse stock split that has a legitimate corporate purpose and that provides for dissenters' rights.<sup>10</sup>

Consistent with this view, the OCC has found that a national bank may undertake a reverse stock split to allow its existing holding company to obtain 100 percent ownership (and freeze out minority shareholders) where there exists a valid corporate purpose and the transaction provides dissenters' rights.<sup>11</sup> The OCC has interpreted section 83 of the National Bank Act to permit a national bank to hold its own stock as part of a reorganization where there exists a legitimate corporate purpose for the transaction. Although section 83 generally prohibits a national bank from purchasing its own stock, the OCC has opined that this prohibition is not absolute. Rather, the primary purpose of section 83 is to prevent a national bank from impairing its capital and endangering creditors in the event of insolvency, by purchasing and holding its own stock.<sup>12</sup>

The OCC has approved reverse stock splits after finding a legitimate corporate purpose in a variety of contexts. For example, a legitimate corporate purpose for a freeze-out exists where the transaction results in reduced costs associated with meeting shareholder communication and registration requirements under the Securities Exchange Act of 1934.<sup>13</sup> Another legitimate business purpose is to freeze out minority shareholders to meet the maximum number of shareholders necessary for a bank to qualify as a Subchapter S corporation.<sup>14</sup> The OCC has codified these reasons as examples of legitimate business purposes in its regulation confirming the ability of national banks to effect reverse stock splits.<sup>15</sup>

A share exchange can achieve exactly the same result as is already available in freeze-out mergers and reverse stock splits. Permitting national banks to use differing types of consideration in share exchanges is consistent with the authority of national banks to use different consideration in freeze-out mergers and reverse stock splits. Case law has made clear the standards a national bank must meet to offer different consideration in those transactions. A national bank share exchange that includes dissenters' rights for all shareholders and has a legitimate business purpose would meet the standards enunciated in *NoDak* and *Bloomington*, as well as OCC conditional approvals and its regulation on reverse stock splits.<sup>16</sup>

### III. Conclusion

We approve the Bank's share exchange, based on our interpretation of the National Bank Act, in light of congressional purpose and case law. We believe that, in cases where a national bank

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<sup>10</sup> *Id.*, 916 F.2d at 1308 n.4, 1309.

<sup>11</sup> See Interpretive Letter No. 786, reprinted in [1997 Transfer Binder] Fed.Banking Law. Rep. (CCH) ¶ 81-213 (June 9, 1997).

<sup>12</sup> Letter from Donald N. Lamson, Assistant Director, SCP (March 27, 1992) (unpublished).

<sup>13</sup> Conditional Approval No. 329 (Sept. 21, 1999).

<sup>14</sup> Conditional Approval No. 344 (Dec. 16, 1999); Conditional Approval No. 342 (Dec. 3, 1999).

<sup>15</sup> See 12 C.F.R. § 7.2023.

<sup>16</sup> See, e.g., Interpretive Letter No. 786, *supra*; Conditional Approval Nos. 369, 342, 344, *all supra*. Although *Lewis* would not permit different forms of consideration in a reverse stock split, this is a minority view and does not impact our analysis in this case.

meets the criteria in section 215a-2,<sup>17</sup> a national bank may offer different forms of consideration to shareholders when it effects a share exchange, for the same reasons applicable in freeze-out mergers and reverse stock splits.

Section 215a-2 does not restrict the ability of a national bank to offer different types of consideration in share exchanges. Permitting banks to provide different consideration is consistent with the language of the statute, which merely lists the corporate formalities to observe in effecting an exchange and the statute's purpose, to permit banks to reorganize efficiently. Congress' intent in enacting section 215a-2 was to provide expedited procedures for national banks effecting reorganizations. Offering differing forms of consideration is consistent with this legislative purpose when it permits banks to streamline the process for effecting the reorganization and, for example, avoid the costs of registering under securities law.

The Bank's share exchange meets the majority standard. It meets all requirements in section 215a-2 and offers dissenters' rights to all shareholders. The transaction's business purpose, to avoid costs associated with registration of holding company shares under the Securities Act, is virtually identical to that recognized in 12 C.F.R. § 7.2023(b)(2), to "reduce costs associated with shareholder communications and meetings." The OCC has recognized a similar purpose in a corporate approval, to reduce costs associated with shareholder communications and registration requirements under the Securities Exchange Act of 1934.<sup>18</sup>

#### **IV. Consummation of the Reorganization**

The OCC will issue a letter acknowledging consummation of the reorganization when the OCC receives:

1. An executed Plan of Reorganization.
2. A certification that the transaction was approved by a majority of the Bank's entire Board of Directors.
3. A certification that shareholder approval was obtained, indicating the percentage of shares voted in favor.
4. A certification that the transaction was approved by the Board of Governors of the Federal Reserve System.

If the reorganization is not consummated within one year from the approval date, the approval shall automatically terminate unless the OCC grants an extension of the time period. Please

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<sup>17</sup> The Bank's share exchange meets these requirements by specifying the manner of the exchange, obtaining shareholder and board approval, stating the consideration to be paid for shares, and providing dissenters' rights.

<sup>18</sup> See Conditional Approval No. 329, *supra*.

advise Brenda McNeese, Senior Licensing Analyst, Southwestern District, within 10 days of the effective date of the reorganization.

Please include the CAIS control number on all correspondence related to this application.

This approval is granted based on a thorough review of all information available, including commitments and representations made in the application and the plan of exchange and those of the Bank's representatives.

This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, United States, any agency or entity of the United States, or an officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable laws and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

If you have any questions concerning this decision, please contact Brenda McNeese, Senior Licensing Analyst, at 214-720-7052.

Sincerely,

**-signed-**

Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel