



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 3, 1999

Conditional Approval #342
January 2000

Phyllis E. Pearson, Esquire
Nyemaster, Goode, Voigts, West, Hansell & O'Brien
700 Walnut, Suite 1600
Des Moines, Iowa 50309-3899

Re: First National Bank of Hampton, Hampton, Iowa ("Bank")
Application Control Number: 99-MW-12-163

Dear Ms. Pearson:

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, subject to the conditions set forth below.

Background

The Bank proposes to amend its bylaws to elect the corporate governance provisions of Iowa law, and proposes to engage in a reverse stock split as provided by Iowa law. The Bank proposes the reverse stock split to enable it to convert to a Subchapter S corporation and to reduce its expenses in conducting shareholder meetings and providing disclosures to minority shareholders.

The Bank proposes to conduct the reverse stock split through a multi-step process. The Bank will reduce the par value of its shares from the current \$100.00 per share to \$0.28 per share.¹ This will reduce capital stock from \$150,000 to \$420. A temporary account titled "Capital Over Par" will be created, with a balance of \$149,580.

The Bank will conduct a reverse stock split at a ratio of 1 to 190. Par value will subsequently increase from \$0.28 to \$60 per share. After the reverse stock split and subsequent increase in par value, 7 full shares plus fractional shares totaling .89 shares will remain outstanding. In lieu of issuing the fractional

¹ The Bank has 1,500 shares outstanding.

shares, the Bank will cash out fractional shares. The Bank is obtaining a valuation of its shares from a local accountant. You have represented that, consistent with Iowa common law, the valuation will not assess any minority or marketability discount on shares.

The Bank will then reclassify each share of common stock as 214.29 shares, increasing the total outstanding shares to 1,500. Simultaneously, the par value will increase from \$60.00 to \$100.00. The Bank's capital stock will then equal \$150,000, eliminating the Capital Over Par account.

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

Iowa statutory law expressly permits state banks to conduct reverse stock splits.³ Iowa statutes also contain provisions governing reverse stock split transactions.⁴ The Bank has represented to the OCC that it will provide the dissenters' rights provided in Iowa Code § 491.1301 *et seq.*, and pay the cost of any resulting appraisal. The Bank has also represented that the Bank will provide for binding arbitration if a court declines to accept jurisdiction in any action seeking appraisal.

Discussion

²12 C.F.R. § 7.2000(b).

³Iowa Code § 524.1509 (1991).

⁴See *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).

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 state in which the main office of the bank is located.⁵ Because the main office of the Bank is located in Iowa, the Bank may elect Iowa corporate governance procedures.

Iowa 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.⁶

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.⁷

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 190 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.⁸ 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.⁹

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

⁵12 C.F.R. § 7.2000(b). The OCC recently amended its regulations expressly to allow national banks to engage in reverse stock splits. 64 Fed. Reg. 60,092, 60,099-100 (Nov. 4, 1999) (to be codified at 12 C.F.R. § 7.2023).

⁶See Interpretive Letter No. 786, *reprinted in* [1997 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 81-213 (June 9, 1997), and Interpretive Letter No. 275, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 85,439 (Oct. 21, 1983).

⁷See 12 U.S.C. § 21a; *see also* 12 U.S.C. § 52 (par value may not exceed \$100 per share).

⁸12 C.F.R. § 5.67(c).

⁹*Id.*

capital stock.¹⁰ 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.¹¹

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 Bancorporation v. Clarke*, 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.¹² 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. Because it is now owned by A.M.Saylor, Incorporated ("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.¹³ The Bank, then, cannot elect to become a Subchapter S corporation unless the Holding Company owns 100 percent of the Bank stock and 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.¹⁴ It also is a valid business purpose to effect a merger in order to reduce corporate expenses associated with shareholder communications and meetings.¹⁵

¹⁰Letter from Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division (March 27, 1992) (unpublished).

¹¹See 12 C.F.R. § 7.2020; Interpretive Letter No. 786, *supra*; Interpretive Letter No. 660, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 83,608 (Dec. 10, 1994).

¹²*NoDak Bancorporation v. Clarke*, 998 F.2d 1416, 1419-20, and 1425 (8th Cir. 1993). Although the Eleventh Circuit in *Lewis v. Clarke* 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. 911 F.2d 1558 (11th Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991). The only Federal Court of Appeals case to address reverse stock splits directly, *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990), decided on the facts that the transaction before it violated the National Bank Act. It declined to determine if reverse stock splits would be permissible for valid business purposes if dissenting shareholders' rights were provided. *Id.* at 1308 n.4, and 1309. The court also specifically noted that the decision was limited to the facts. *Id.*

¹³ See 26 U.S.C. §§ 1361(b)(1), (3).

¹⁴ See *Leader v. Hycor, Inc.*, 479 N.E.2d 173, 178 (Mass. 1985); see also *Nash v. Farmers New World Life*, 1976 U.S. Dist. 15,846, *48 (S.D. Ohio 1976).

¹⁵See *Teschner v. Chicago Title & Trust Co.*, 322 N.E.2d 54, 58 (Ill. 1974).

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.¹⁶

Iowa law governing reverse stock splits provides minority shareholders with dissenters' rights. Because the Bank is adopting Iowa law, minority shareholders in the reverse stock split will receive dissenter's rights comparable to those under the National Bank Act in mergers and consolidations.¹⁷

Conclusion

¹⁶Iowa law requires corporations to provide shareholders with advance notice of the right to dissent. Iowa Code § 490.1320. Advance notice of dissenters' rights is important to allow minority shareholders to decide whether to exercise dissenters' rights.

¹⁷Under 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).

Iowa law governing reverse stock splits provides minority shareholders with dissenters' rights. 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 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. 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.

For the above reasons, including the representations and commitments made by the Bank, 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 Iowa law.
2. The Bank will provide for dissenters' rights as described in Iowa Code § 490.1301 *et seq.*
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 by an independent third party.

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, and the dollar amount of the reduction in the common stock and surplus account associated with the payment for fractional shares. 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.

The reverse stock split should be completed within one year of the date of this letter. If you have any questions, please contact John Morgan, Senior Attorney, Midwestern District Office, at 816-556-1870, Frederick Petrick, Senior Attorney, Securities and Corporate Practices Division, at 202-874-5210, Michael E. Copeland, National Bank Examiner/Corporate Analyst, Midwestern District Office, at 816-556-1860, or Beverly Evans, Senior Bank Structure Analyst, Bank Organization and Structure, at 202-874-5060.

Sincerely,

/s/

Steven J. Weiss
Deputy Comptroller
Bank Organization and Structure