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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

February 11, 2010

**Interpretive Letter #1125**  
**March 2010**  
**12 CFR 7.2000(b)**

Subject: Share Reclassification Pursuant to Tennessee State Corporate Law

Dear [ ]:

This responds to your request for confirmation that [ ], [ *City, State* ] (the “Bank”), which has elected Tennessee law as its corporate governance process under 12 C.F.R. § 7.2000(b), may reclassify common stock held by the Bank’s shareholders into new classes of preferred stock in accordance with Tennessee law. For the reasons described below, we conclude that the Bank may, after filing an application under 12 C.F.R. § 5.46 and receiving the OCC’s approval, effect the proposed share reclassification.

**I. FACTUAL DESCRIPTION**

**A. Share Reclassification Plan**

In order to effectuate the share reclassification, the Bank proposes reclassifying certain common shares into two new classes of preferred stock.<sup>1,2</sup> The Bank proposes the share reclassification to enable it to transform from a reporting company under the Securities Exchange Act of 1934 (the “Exchange Act”) to a nonreporting company, and to reduce administrative expenses and costs of shareholder communications incurred as a result of being a public company.

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<sup>1</sup> The Bank’s Articles of Association authorizes two classes of shares: common stock, with unlimited voting rights, and preferred stock, whose number, designation, powers, preferences, and voting rights are left to the Bank’s board of directors to determine. The new preferred stock classes will differ on voting rights and have dividend and liquidation preferences vis-à-vis the common stock.

<sup>2</sup> The Bank represents that the share reclassification will comply with applicable securities laws and regulations. Specifically, the share reclassification will be consistent with the applicable provisions under the Securities Exchange Act of 1934 (the “Exchange Act”) relating to “going private” transactions (Exchange Act Rule 13e-3 and Schedule 13E-3), and the share reclassification securities disclosures will be subject to the OCC’s review and approval when filed.

Under the share reclassification plan, all shareholders holding between 1,000 and 500 shares of common stock will be exchanged, on a one-for-one basis, with shares of a new class of preferred stock, designated as “Class A Preferred Stock.”<sup>3</sup> The Bank believes that there will be fewer than 400 holders of Class A Preferred Stock immediately following the reclassification.

All shareholders holding less than 500 shares of common stock would be exchanged, on a one-for-one basis, with shares of a different new class of preferred stock, designated “Class B Preferred Stock.”<sup>4</sup> All shareholders holding more than 1,000 shares of common stock will retain their common stock ownership. There will be fewer than 200 holders of common stock immediately following the reclassification.<sup>5</sup>

The Bank will seek the approval of holders of two-thirds of the Bank’s shares on (1) the share reclassification; (2) the reduction of capital resulting from the Bank’s acquisition of its common stock from shareholders who exercise their dissenters’ rights;<sup>6</sup> and (3) the Bank’s issuance of the two classes of preferred stock in the share reclassification transaction.

## **B. Dissenters’ Rights**

The Bank represents that it will provide dissenters’ rights, as provided in the Tennessee Business Corporation Act (the “Tennessee Code”). Under that Code, shareholder dissenters’ rights are triggered by “[a]ny corporate action taken pursuant to a shareholder vote to the extent the charter, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.”<sup>7</sup> While a share reclassification transaction does not automatically trigger statutory dissenters’ rights under the Tennessee Code, the Bank will grant, through a resolution of the board of directors, dissenters’ rights to its shareholders. In addition, the Bank will give prior notice of dissenters’ rights to shareholders before the shareholders’ meeting acting on the proposal,<sup>8</sup> pay the cost of any

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<sup>3</sup> Class A Preferred Stock will (a) be nonvoting, except with regard to business transactions (where it would have one vote per share and vote with the remaining common shareholders); (b) have the right to a dividend that is 5% greater than any dividend paid to common shareholders; and (c) be entitled to a liquidation preference vis-à-vis the common stock.

<sup>4</sup> Class B Preferred Stock will (a) be non-voting except as required by law; (b) have a 10% dividend preference; and (c) have a liquidation preference vis-à-vis the common stock and Class A Preferred Stock.

<sup>5</sup> Both Class A and Class B Preferred Stock will convert back into common stock in the event of a change in control of the Bank or in the event the Bank elects to re-register its shares of common stock.

<sup>6</sup> The Bank will provide dissenters’ rights under Tennessee law in the proposed share reclassification that are comparable to those under the National Bank Act in mergers, consolidations and share exchanges. The Bank represents that any cash consideration extended by the Bank to repurchase dissenters’ shares would be a reduction in capital. Accordingly, the Bank would seek the OCC’s approval and two-thirds’ shareholder approval required for reductions of capital under 12 U.S.C. § 59.

<sup>7</sup> Tenn. Code Ann. § 48-23-102(a)(5).

<sup>8</sup> Tenn. Code Ann. § 48-23-201(a).

appraisal in a court proceeding, and provide for binding arbitration if a court declines to accept jurisdiction in any action seeking appraisal.

Under the Tennessee Code, a shareholder who wishes to assert dissenters' rights must provide advance notice to the corporation, and may not vote in favor of the action.<sup>9</sup> Within 10 days of the shareholder meeting, the Bank must send another notice to shareholders that are eligible to demand payment, and this notice must set a date, between one and two months after delivery of the notice, by which the shareholder must make a written demand (a form of which will be included in the notice) on the Bank for the fair value of the shares.<sup>10</sup> In the event that the dissenting shareholder and the Bank do not agree on the fair value of the shares, the Bank may, within two months of receiving the dissenters' estimate of fair value, file a petition for appraisal in the appropriate state court.<sup>11</sup>

## **II. DISCUSSION**

### **A. Corporate Governance**

The Bank proposes to effect the share reclassification under Tennessee corporate law and OCC Regulation 7.2000(b). Under 12 C.F.R. § 7.2000(b), a national bank can elect to follow state corporate governance procedures when not inconsistent with federal banking law and safe and sound corporate governance procedures. The OCC's regulation provides:

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 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). The Bank's main office is located in Morristown, Tennessee. As noted above, the Bank has designated Tennessee corporate law in its bylaws for its corporate

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<sup>9</sup> Tenn. Code Ann. § 48-23-202. *See also* Tenn. Code Ann. § 48-23-204.

<sup>10</sup> Tenn. Code Ann. § 48-23-203.

<sup>11</sup> Tenn. Code Ann. § 48-23-301.

governance procedures.

## **1. Tennessee Law Permits Share Reclassification**

Tennessee corporate law does not specifically address the authority of a business corporation to effect a share reclassification. However, the Tennessee Code does permit corporate actions that are elements of share reclassification transactions. In particular, the Bank represents that the Tennessee Code authorizes a corporation to acquire its own shares,<sup>12</sup> and hold reacquired shares as authorized but unissued shares.<sup>13</sup> Further, the Tennessee Code permits a corporation to authorize multiple classes of stock with different rights and privileges,<sup>14</sup> and to issue new shares of stock as consideration for the acquisition of outstanding common shares held by the corporation's shareholders.<sup>15</sup> Thus, the Bank represents that share reclassifications are permitted under Tennessee law.<sup>16</sup>

## **2. Share Reclassification is a Corporate Governance Procedure**

The Bank's decision to effect a share reclassification is a "corporate governance procedure" under 12 C.F.R. § 7.2000(b). The regulation does not define the term "corporate governance procedure." However, the OCC has stated that the term is meant to refer to "those matters involving the operation and mechanics of the bank's internal organization, including relations among the owners-investors, directors and officers, as distinct from the bank's banking powers and activities and its relationship with customers and third parties."<sup>17</sup> The OCC has previously authorized national banks to follow "corporate governance procedures" under state law permitting the division of a financial institution into two separate entities, reverse stock splits, share exchanges, and the issuance of blank check preferred stock.<sup>18</sup> Because effecting a share reclassification involves relations among owners-investors, it constitutes a corporate governance procedure.

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<sup>12</sup> Tenn. Code Ann. § 48-16-302.

<sup>13</sup> Tenn. Code Ann. § 48-16-302.

<sup>14</sup> Tenn. Code Ann. § 48-16-101.

<sup>15</sup> The Tennessee Code allows the board of directors of a corporation to issue shares for consideration consisting of any tangible or intangible property or benefit to the corporation, and the adequacy of the consideration given for the shares is to be determined entirely by the board of directors. *See* Tenn. Code Ann. §§ 48-16-202(b) and 48-16-202(c).

<sup>16</sup> The Bank represents that four Tennessee financial institutions have completed share reclassifications in order to transform from reporting companies under the Exchange Act to nonreporting companies over the past five years.

<sup>17</sup> OCC Conditional Approval No. 696 (June 9, 2005).

<sup>18</sup> *See e.g.*, OCC Conditional Approval No. 859 (June 13, 2008); OCC Conditional Approval No. 670 (Dec. 27, 2004); OCC Interpretative Letter No. 879 (Nov. 10, 1999); OCC Interpretative Letter No. 921 (Dec. 13, 2001).

### 3. Effecting a Share Reclassification Is Not Inconsistent with Federal Banking Law and Safety and Soundness

Tennessee corporate law permitting share reclassification is not inconsistent with federal banking statutes and regulations, or with bank safety and soundness. The OCC has not previously considered whether a national bank can effect a share reclassification, and federal banking law does not specifically address the authority of national banks to reorganize by effecting a share reclassification and providing different types of consideration to shareholders in the exchange.<sup>19</sup> There are a number of mechanisms, however, by which a national bank may reorganize, and, as a result, provide different types of consideration to shareholders. For example, in undertaking an ownership restructuring pursuant to 12 U.S.C. § 215a-2, a bank may pay shareholders different forms of consideration in a share exchange, so long as full dissenters' rights are provided to minority shareholders and the transaction serves a legitimate corporate purpose.<sup>20</sup> In a prior approval of such a share exchange transaction under 12 U.S.C. § 215a-2,<sup>21</sup> the OCC stated that the National Bank Act authorizes banks to offer different classes of shareholders different consideration, as is proposed under the Bank's share reclassification plan.

In addition, the OCC permits share reclassification resulting from reverse stock splits authorized under 12 C.F.R. § 7.2023. Section 7.2023 of 12 C.F.R. codified prior OCC precedents concluding that a national bank may engage in a reverse stock split, as long as the bank provides adequate protection for dissenting shareholders' rights and serves a legitimate corporate purpose.<sup>22</sup> The OCC has determined that its requirement that reverse stock transactions must provide for dissenters' rights is consistent with the court decision, *NoDak Bancorp v. Clarke*, 998 F.2d 1416 (8<sup>th</sup> Cir. 1993), in which the court upheld the OCC's approval of a cash-out merger where the OCC found that there was a valid corporate purpose for the transaction and that minority shareholders were entitled to dissenters' rights. In an earlier decision, the Eleventh Circuit found in *Lewis v. Clark[e]*, 911 F.2d 1558 (11<sup>th</sup> Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991), that the OCC lacked authority to approve a bank merger that required minority shareholders to accept cash for their shares while the majority shareholders were eligible to receive stock in the resulting bank, even where the minority shareholders had appraisal rights. The *NoDak* court distinguished *Lewis v. Clark[e]*, finding that a national bank could cash out minority shareholders under the National Bank Act, as long as there is a valid business purpose

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<sup>19</sup> We note, however, that the OCC has previously recognized that national banks may effect transactions that have similar characteristics to share reclassifications, *e.g.*, reverse stock splits. *See* OCC Conditional Approval Nos. 541 (July 30, 2002) and 434 (Dec. 15, 2000).

<sup>20</sup> OCC Corporate Decision No. 2002-08 (May 15, 2002); and 12 U.S.C. § 215a-2(c).

<sup>21</sup> OCC Corporate Decision No. 2008-01 (Dec. 12, 2007).

<sup>22</sup> *See* 64 FR 31749 and 64 FR 60092. The National Bank Act also provides for dissenters' rights as part of certain conversion, merger, or consolidation transactions, or as part of other reorganization transactions that involve exchanging bank stock for holding company stock. 12 U.S.C. §§ 214a(b), 215(b)-(d), 215a(b)-(d), and 215a-2(c).

and the minority shareholders are entitled to dissenters' rights.<sup>23</sup> To clarify how the OCC applies the governing law in light of these decisions, the OCC's regulations reflect the OCC's position that the better reasoned view in the federal courts is that reverse stock splits will be approved if there is a legitimate corporate purpose and if shareholders are provided adequate dissenters' rights.

## **B. Dissenters' Rights**

The proposed share reclassification is the same type of transaction as a reverse stock split or a share exchange under 12 U.S.C. § 215a-2 where shareholders receive different forms of consideration, and the share reclassification will have a similar effect on minority shareholders. Accordingly, consistent with the OCC's regulation addressing reverse stock splits and National Bank Act provisions addressing mergers and share exchanges, national banks that effect a share reclassification should provide adequate dissenters' rights to those shareholders who choose not to receive preferred stock by dissenting from the transaction.

The Bank represents that it will provide dissenters' rights under Tennessee law in the proposed share reclassification that are comparable to those under the National Bank Act in mergers, consolidations and share exchanges.<sup>24</sup>

Tennessee law in one respect is not consistent with the dissenters' rights available in federal banking law. When a dispute over the fair value of the shares arises, the Tennessee Code requires that the matter be brought before a state court, while the National Bank Act provides that the OCC will determine the fair value of the shares. Section 7.2000(b) of 12 C.F.R. limits

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<sup>23</sup> In *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7<sup>th</sup> Cir. 1990), the court reversed the OCC's approval of a reverse stock split. The court held that the reverse stock split plan 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.

<sup>24</sup> Under 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 shareholders' 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. See 12 U.S.C. §§ 214a(b), 215(b)-(d), 215a(b)-(d), and 215a-2(c). Under Tennessee law, a shareholder who wishes to assert dissenters' rights must provide advance notice to the corporation, and may not vote in favor of the action. Tenn. Code Ann. § 48-23-202. See also Tenn. Code Ann. § 48-23-204. Within 10 days of the shareholder meeting, the Bank must send another notice to shareholders that are eligible to demand payment, and this notice must set a date, between one and two months after delivery of the notice, by which the shareholder must make a written demand (a form of which will be included in the notice) on the Bank for the fair value of the shares. Tenn. Code Ann. § 48-23-203. In the event that the dissenting shareholder and the Bank do not agree on the fair value of the shares, the Bank may, within two months of receiving the dissenters' estimate of fair value, file a petition for appraisal in the appropriate state court. Tenn. Code § 48-23-301.

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 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 Tennessee law) or the Comptroller (under the National Bank Act) determines the fair value of the shares.

the ability of national banks to adopt alternative corporate governance to only those statutes that are not inconsistent with federal banking law. National bank shareholders must therefore not suffer a disadvantage resulting from the bank's selection of that alternative law. To meet this limitation in section 7.2000(b), a national bank proposing to conduct a share reclassification should agree to pay the cost of any judicial appraisal of the dissenters' shares that may result.<sup>25</sup> The Bank represents that it will do so, and to pay for binding arbitration of the matter if the appropriate court refuses jurisdiction of an appraisal action. As discussed below, in order to ensure adequate protection for dissenting shareholders, the OCC will impose appropriate conditions on the corporate application approval that will be necessary for the Bank to engage in this transaction.

### **C. Legitimate Corporate Purpose**

The OCC has approved reverse stock splits and share exchanges after finding a legitimate corporate purpose in a variety of contexts. For example, a legitimate corporate purpose exists where the transaction results in reduced costs associated with meeting shareholder communication and registration requirements under the Exchange Act.<sup>26</sup> Another legitimate business purpose is to reduce the number of minority shareholders and, thereby, meet the maximum number of shareholders necessary for a bank to qualify as a Subchapter S corporation.<sup>27</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>28</sup>

The Bank has articulated legitimate business purposes for effecting a share reclassification. The Bank represents that it wants to transform from a reporting company under the Exchange Act to a nonreporting company to reduce costs associated with shareholder communications and meetings. Eliminating burdens associated with a shareholder constituency is a proper business purpose.

A share reclassification can achieve exactly the same result as is already available in reverse stock splits and share exchanges. Permitting national banks to use differing types of consideration in share reclassifications is consistent with the authority of national banks to use different consideration in share exchanges, mergers to reduce the number of shareholders, and reverse stock splits. Case law has made clear the standards a national bank must meet to offer different consideration in those transactions.<sup>29</sup> A national bank share reclassification that

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<sup>25</sup> *Cf.*, e.g., OCC Conditional Approval Nos. 329 (Sept. 21, 1999), 434 (Dec. 15, 2000), 541 (July 30, 2002), 683 (Apr. 7, 2005) and 766 (Oct. 12, 2006) (letters requiring banks effecting reverse stock splits to pay for the cost of any appraisals, if any shareholders dissent from the reverse stock split).

<sup>26</sup> OCC Conditional Approval No. 329 (Sept. 21, 1999); OCC Corporate Decision No. 2002-08 (May 15, 2002).

<sup>27</sup> OCC Conditional Approval No. 344 (Dec. 16, 1999); OCC Conditional Approval No. 342 (Dec. 3, 1999).

<sup>28</sup> *See* 12 C.F.R. § 7.2023.

<sup>29</sup> *See* OCC Corporate Decision No. 2002-08 (May 15, 2002).

includes dissenters' rights for all shareholders and has a legitimate business purpose meets the standards enunciated in case law, as well as OCC conditional approvals and the OCC's regulation authorizing reverse stock splits.<sup>30</sup>

### III. CONCLUSION

For the reasons above, we conclude that the Bank may, after filing an application under 12 C.F.R. § 5.46 and receiving the OCC's conditional approval,<sup>31</sup> effect a share reclassification. The application should be filed with Brenda McNeese, Senior Licensing Analyst, Office of the Comptroller of the Currency, 500 North Akard Street, Suite 1600, Dallas, Texas 75201. Ms. McNeese can be reached by phone at 214-720-7069. If you have any questions concerning this letter, please contact Asa L. Chamberlayne, Counsel, Securities and Corporate Practices Division, at 202-874-5210.

Sincerely,

- signed -

Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel  
Comptroller of the Currency

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<sup>30</sup> See, e.g., OCC Interpretive Letter No. 786 (June 9, 1997); OCC Conditional Approval Nos. 329 (Sept. 21, 1999), 342 (Dec. 3, 1999), 344 (Dec. 16, 1999); 12 C.F.R. § 7.2023. Although the court in *Lewis v. Clark[e]*, 911 F.2d 1558 (11<sup>th</sup> Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991), would not permit different forms of consideration in a reverse stock split, this is a minority view and does not control our analysis in this case.

<sup>31</sup> The OCC's approval of the Bank's application to effect a share reclassification would be subject to the following conditions:

1. The Bank must provide for dissenters' rights as provided in the Tennessee Code.
2. If any shareholders dissent from the share reclassification, the Bank must pay the cost of any appraisal that may occur, but not the costs of attorneys' fees incurred by and costs of experts retained by dissenting shareholders.
3. If the appropriate court(s) decline to accept jurisdiction of an appraisal action, the Bank must pay for binding arbitration by an independent third party to appraise the stock, but not the costs of attorneys' fees incurred by and costs of experts retained by dissenting shareholders.