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**Comptroller of the Currency  
Administrator of National Banks**

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Washington, DC 20219

**Corporate Decision #97-50  
July 1997**

June 20, 1997

Patrick B. Augustine, Esquire  
McKenna & Cuneo, L.L.P.  
Suite 4800  
370 Seventeenth Street  
Denver, CO 80202-1370

Re: Aurora National Bank, Aurora, Colorado (“Bank”)  
Application Control Number: 97-WE-12-0132

Dear Mr. Augustine:

This responds to the Bank’s application under 12 C.F.R. § 5.46 to elect the corporate governance provisions of Colorado 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 amended its articles of association (“articles”) in 1996 to elect the corporate governance provisions of Colorado law,<sup>1</sup> and proposes to engage in a reverse stock split as provided by Colorado law. The Bank proposes the reverse stock split to enable the holding company to increase its ownership to 100 percent of the Bank’s shares, convert to a Subchapter S corporation and to reduce its expenses in conducting shareholder meetings. The Bank also wishes to convert to a Subchapter S corporation to decrease taxes and corporate expenses and make more earnings available for growth through acquisition and branching. The Bank also seeks to increase the opportunity to obtain third-party financing by virtue of being a wholly-owned company without minority shareholders. Subchapter S status would increase the likelihood of obtaining such financing because the Bank’s holding company, Citywide Banks, Inc. (“holding company”), would be able to pledge all the Bank’s stock to support such financing.

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<sup>1</sup>You represented that the Bank’s shareholders approved an amendment to the articles electing Colorado corporate governance law in accordance with 12 U.S.C. § 21a, and the board of directors made similar provisions in the bylaws.

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 \$10 to \$1 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 \$250,000 (25,000 shares at \$10 par) to \$25,000 (25,000 shares at \$1 par). The Bank will transfer the amount "in excess of par," \$225,000, from the common stock account to a temporary account designated "capital over par" that would be used to meet the Bank's \$250,000 statutory minimum capital requirement. *See* 12 U.S.C. § 51. Then the Bank will complete a reverse stock split at a ratio of 100:1 and increase par value to \$100. The Bank will pay \$89,980 for fractional shares, aggregating 1.1 post-split shares, recording a dividend for the payout. The Bank will then issue 2,251.1 additional shares to the holding company in the form of a stock dividend to return the "capital over par" account to the common stock account.

### **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).

Colorado statutory law expressly permits state banks to conduct reverse stock splits. Colo. Rev. Stat. § 7-106-105 (1996 Supp.). Colorado statutes also contain provisions governing reverse stock split transactions. *See id.* at §§ 7-106-104(a) (corporation may pay in cash the value of fractions of a share of stock); 7-106-302 (a corporation may acquire its own shares); 7-113-102(2.5)(d) (dissenters' rights for shareholders in reverse stock splits); and 11-4-105 (dissenters' rights in merger of financial institutions and the right to an appraisal). Moreover, Colorado case law has permitted banks to engage in reverse stock splits and eliminate

minority shareholders. *See Goldman v. Union Bank and Trust*, 765 P.2d 638 (Colo. App. 1988).<sup>2</sup>

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.<sup>3</sup> 12 U.S.C. § 59. A national bank may engage in a number of corporate combinations, including mergers and consolidations, but it must provide dissenters' rights. 12 U.S.C. §§ 214a-215a. Section 83 generally prohibits a national bank from purchasing, or making a loan secured by, its own stock. 12 U.S.C. § 83. 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. *See* 12 C.F.R. § 7.2020 and Interpretive Letter No. 660, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. ¶ 83,608 (Dec. 10, 1994).

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<sup>2</sup>*Goldman* involved a suit by minority shareholders to enjoin a reverse stock split involving cash payment for, and cancellation of, fractional shares. The court concluded that predecessors to current Colorado statutory provisions permitted a bank to eliminate its fractional shares through a reverse stock split, provided a legitimate business purpose for the split existed. The court declined to rule whether such a purpose existed, because it was a fact question being presented for the first time on appeal. *Id.* at 640.

<sup>3</sup>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 company controls over 99 percent of the Bank's common stock.

The OCC routinely had approved national bank reverse stock splits until 1990,<sup>4</sup> 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. *See Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990). 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.

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. *See Bloomington Nat'l Bank v. Telfer*, 699 F. Supp. 190 (S.D. Ind. 1988). 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." *Id.*, 699 F. Supp. at 194. Because the National Bank Act provides explicit authority for freeze-outs only in sections 214a through 215a, and the

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<sup>4</sup>The 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. ¶ 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. ¶ 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.

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

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 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. *Lewis v. Clark*, 911 F.2d 1558 (11th Cir. 1990), *reh'g denied*, 972 F.2d 1351 (1991). 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 is a valid business purpose for the transaction and the minority shareholders are entitled to dissenters' rights. *NoDak Bancorporation v. Clarke*, 998 F.2d 1416 (8th Cir. 1993).

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. *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). Reducing corporate expenses and simplifying corporate procedures are also legitimate business purposes. *Teschner, supra*, 322 N.E.2d at 54.

The OCC recently 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. *See* Letter from Julie L. Williams, Chief Counsel (June 9, 1997) ("Williams Letter"). In that letter, the bank cited as its legitimate business purpose its intention to elect Subchapter S corporation status and reduce costs associated with conducting shareholders meetings.

## **Discussion**

The Bank may adopt Colorado 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. 12 C.F.R. § 7.2000(b). Because the main office of the Bank is located in Colorado, the Bank may elect Colorado corporate governance procedures.

Colorado 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 dissenting shareholder rights are provided. *See also* Williams Letter and Interpretive Letter No. 660, *supra*.

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 shares of common stock with new common stock at the rate of one share of new common stock for each 100 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. § 7.2023(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, Williams Letter, 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>5</sup> Thus,

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<sup>5</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.

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 currently has fewer than 75 shareholders and already may qualify for Subchapter S status on that account, but the Bank believes that it cannot currently obtain the unanimous shareholder consent required to become a Subchapter S corporation. Qualification for Subchapter S status requires obtaining unanimous shareholder approval as well as achieving the required maximum number of shareholders. *See* 26 U.S.C. §§ 1361(b)(1)(A) and 1362(a)(2). Accordingly, the Bank can pursue the reverse stock split in order ultimately to obtain the unanimous shareholder approval for reorganizing as a Subchapter S corporation. Eliminating the responsibilities associated with a publicly held company 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.<sup>6</sup>

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.

Colorado law governing reverse stock splits provides minority shareholders with dissenters' rights.<sup>7</sup> Colorado Rev. Stat. § 7-113-102(2.5). Banks must include notice of dissenters' rights

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<sup>6</sup>As the Bank has established a valid business purpose, it is unnecessary to address the third and fourth reasons (retaining earnings to facilitate growth through acquisition and branching, and to increase the opportunity to obtain third-party financing to achieve growth) advanced by the Bank for undertaking the reverse stock split.

<sup>7</sup>Colorado law generally creates a detailed statutory scheme governing dissenters' rights. *See* Colo. Rev. Stat. § 7-113-101 *et seq.* Similarly, the National Bank Act provides for dissenters' rights. 12 U.S.C. §§ 214a(b), 215(b)-(d), and 215a(b)-(d). 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 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. This difference is not material because both codes provide a mechanism whereby a nonvoting shareholder may still dissent and receive payment for the shares.

with the notice for the meeting at which the shareholders will vote on the reverse stock split. *Id.* at § 7-113-201. 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 § 7-113-202. After the meeting, the bank must send written notice to all dissenters concerning the procedure for demanding payment. *Id.* at § 7-113-203. Dissenting shareholders must then demand payment, and the bank must make payment to the shareholders. *Id.* at §§ 7-113-204 and 7-113-206. Any shareholder who is dissatisfied with the payment offered must provide the bank with an estimate of fair value. *Id.* at § 7-113-209. The bank must then either pay the amount requested by the shareholder, or seek an appraisal from the court. *Id.* at § 7-113-301. In an appraisal proceeding, the court has substantial latitude to assess fees and expenses of the proceeding against either party. *Id.* at § 7-113-302.

The dissenters' rights for Bank shareholders under Colorado 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 Colorado law) or the Comptroller (under the National Bank Act) ultimately determines the fair value of the 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. Please notify 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 issuance of the additional 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, OCC will authorize the reduction in capital attributable to the payment for the fractional shares and will certify the subsequent increase in capital attributable to the issuance of the additional 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 Lee Walzer, Senior Attorney, Securities and Corporate Practices Division at 202-874-5210, Nancy Cody, National Bank Examiner, Bank



Organization and Structure at 202-874-5060, or Geryl Race, National Bank Examiner, at 415-545-5922.

Sincerely,

/s/

**Julie L. Williams**  
Chief Counsel