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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

**Conditional Approval #434**  
**January 2001**

December 15, 2000

John W. Wright, Esquire  
McDonald Sanders, PC  
777 Main Street, Suite 1300  
Fort Worth, Texas 76102

Re:       Worth National Bank, Lake Worth, Texas ("Bank")  
          Application Control Number: 1999-SW-12-0247

Dear Mr. Wright:

This responds to the Bank's application under 12 C.F.R. § 5.46 to elect the corporate governance provisions of Texas 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 Texas law, and proposes to engage in a reverse stock split as permitted by Texas law. The Bank proposes the reverse stock split to enable it to reduce corporate expenses and simplify corporate procedures, specifically by reducing administrative costs associated with maintaining records, providing notices of shareholders' meetings, and conducting shareholders' meetings.

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 \$10.00 per share to \$1.00 per share.<sup>1</sup> This will reduce capital stock from \$1,049,910 to \$104,991. A temporary account titled "Capital Over Par" will be created with a balance of \$944,919.

The Bank will conduct a reverse stock split at a ratio of 60 to 1. Par value will subsequently increase from \$1 to \$60 per share. After the reverse stock split and subsequent increase in par

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<sup>1</sup> The Bank has 104,991 shares of common stock outstanding.

value, 1,749 full shares plus fractional shares totaling .85 shares will remain outstanding. In lieu of issuing the fractional shares, the Bank will cash out fractional shares. The Bank obtained a valuation of its shares based on recent sales of Worth Bancorporation, Inc. (“Holding Company”) shares.<sup>2</sup> You have represented that the valuation will not result in any minority discount on shares.

The Bank will then issue approximately 15,749 additional shares (at \$60 par value per share) in the form of a stock dividend to eliminate the “Capital Over Par” account and return the capital stock account to at least \$1,049,910.

### **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.<sup>3</sup>

Texas corporate law does not specifically address the authority of a business corporation to engage in a reverse stock split transaction. Like federal banking statutes, however, particular provisions of the Texas Business Corporation Act do permit certain corporate actions characteristic of reverse stock split transactions. A Texas corporation may, for example, amend its articles of incorporation to reduce par value and to effect a reclassification, exchange, or cancellation of shares.<sup>4</sup> Similarly, a corporation may make distributions to purchase its own shares to eliminate fractional shares, and to pay dissenting shareholders entitled to payment under the Act.<sup>5</sup> Shareholders have the right under Texas law to dissent from particular corporate actions including certain mergers, significant actions involving the assets of a corporation, and exchanges, and to receive payment for the fair value of their shares where dissent is permitted.<sup>6</sup>

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<sup>2</sup> The Holding Company owns 104,939 shares of Bank stock, or approximately 99.95% of all issued and outstanding shares. The Bank represents approximately 95.96% of the value of the Holding Company.

<sup>3</sup> 12 C.F.R. § 7.2000(b).

<sup>4</sup> See TEX. BUS. CORP. ACT ANN. art. 4.01 and 4.03A(2).

<sup>5</sup> See *id.* at art. 2.38(2)(a) and (c).

<sup>6</sup> See *id.* at art. 5.11 and 5.12.

Thus, the Bank believes that reverse stock splits are permitted under Texas law.<sup>7</sup> Although Texas law does not expressly provide for dissenters' rights in connection with a reverse stock split, the Bank has represented that it will provide dissenters' rights. The Bank will give prior notice of dissenters' rights to minority interest holders before the shareholder meeting acting on the proposal, pay the cost of any resulting appraisal, and provide for binding arbitration if a court declines to accept jurisdiction in any action seeking appraisal.

## Discussion

The Bank may adopt Texas corporate governance procedures to the extent that those procedures are not inconsistent with applicable Federal banking statutes or regulations. OCC regulations expressly permit 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.<sup>8</sup> The Bank may elect Texas corporate governance procedures because the main office of the Bank is located in Texas.

The Bank represents that reverse stock split transactions are permitted under Texas law, and are consistent 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.<sup>9</sup>

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 resulting 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.<sup>10</sup> The National Bank Act permits a national bank to reduce its capital upon the vote of shareholders holding two-thirds of its capital stock and OCC approval.<sup>11</sup> In this case, the required shareholder vote approving the proposed reduction in

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<sup>7</sup> Analogous authority under the Texas Administrative Code authorizes specific procedures for reverse stock splits by Texas state banks. *See* TEX. ADMIN. CODE tit. 7, § 15.122 (Amendment of Articles To Effect a Reverse Stock Split). Texas state courts also have acknowledged indirectly the permissibility of reverse stock splits. *See, e.g., Lewis v. Knutson*, 699 F.2d 230 (5th Cir. 1983) and *Zauber v. Murray Savings Ass'n*, 591 S.W.2d 932 (Tex. Civ. App. - Dallas 1979), *writ ref'd n.r.e. per curiam*, 601 S.W.2d 940 (Tex. 1980).

<sup>8</sup> *See* 12 C.F.R. § 7.2000(b).

<sup>9</sup> OCC regulations expressly allow national banks to engage in reverse stock splits. *See* 12 C.F.R. § 7.2023; *see also* OCC Advisory Letter No. 2000-4 (Reverse Stock Split Procedures), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 47-370, Interpretive Letter No. 786 (June 9, 1997), *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-213, and Interpretive Letter No. 275 (October 21, 1983), *reprinted in* [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,439.

<sup>10</sup> *See* 12 U.S.C. § 21a; *see also* 12 U.S.C. § 52 (par value may not exceed \$100 per share).

<sup>11</sup> *See* 12 U.S.C. § 59.

capital as part of the reverse stock split is assured, as the holding company controls more than two-thirds of the Bank's capital stock.

The Bank next proposes to replace each of the outstanding shares of common stock with new common stock at the rate of one share of new common stock for each 60 shares of outstanding common stock. The Bank will pay cash for any fractional shares outstanding. National banks have express authority to pay the cash equivalent of fractional shares of stock.<sup>12</sup> 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.<sup>13</sup>

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.<sup>14</sup> 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.<sup>15</sup>

Judicial authority also provides support for concluding that reverse stock splits for legitimate business purposes are consistent with the National Bank Act. In *NoDak Bancorporation v. Clarke*, the Eighth Circuit held that a national bank could effect a freeze-out merger 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.<sup>16</sup> The *NoDak* court found that a national bank may engage in any merger not inconsistent with 12 U.S.C. §§ 214a and 215-215a, and that freeze-out mergers are consistent with those sections.<sup>17</sup> Thus, applicable statutory provisions and

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<sup>12</sup> See 12 C.F.R. § 5.67(c).

<sup>13</sup> "The cash equivalent is based on the market value of the stock, if there is an established and active market in the national bank's stock." See *id.* Based on information provided by the Bank, OCC staff determined that the Bank demonstrated the presence of an active informal market for Holding Company shares on which to base a fair market valuation determination for fractional shares.

<sup>14</sup> See Letter from Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division (March 27, 1992) (unpublished).

<sup>15</sup> See 12 C.F.R. § 7.2020; see also Interpretive Letter No. 786, *supra* note 9 and Interpretive Letter No. 660 (December 10, 1994), reprinted in [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,608.

<sup>16</sup> See *NoDak Bancorporation v. Clarke*, 998 F.2d 1416 (8th Cir. 1993).

<sup>17</sup> See *id.* at 1419-20, 1425. Although the Eleventh Circuit has held that national banks may not effect freeze-out mergers that require holders of stock of equal standing to take different forms of considerations, this is a minority view. See *Lewis v. Clarke*, 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. See *id.* at 1308 n.4, 1309. The court also noted that the decision was limited to the facts of the case. See *id.*

certain judicial precedent would permit reverse stock splits for legitimate business purposes, provided dissenters' rights are available.

The Bank has legitimate business purposes in effecting a reverse stock split. The Bank wishes to reduce corporate expenses and simplify corporate procedures. Specifically, the Bank desires to reduce administrative costs associated with maintaining the existing number of shareholders, such as maintaining records with respect to these shareholders, providing notices of shareholders' meetings, and conducting shareholders meetings. By conducting a reverse stock split, the Holding Company will own 100 percent of the Bank's shares, thus eliminating corporate expenses and simplifying corporate procedures. Eliminating burdens associated with a large shareholder constituency is a proper business purpose.<sup>18</sup> It is also a valid business purpose to effect a merger in order to reduce corporate expenses associated with shareholder communications and meetings.<sup>19</sup>

To avoid undermining the purposes of 12 U.S.C. §§ 214a and 215-215a, 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.

Minority shareholders in the reverse stock split will receive dissenters' rights comparable to those under the National Bank Act in mergers and consolidations.<sup>20</sup> Specifically, the Bank has represented that it will provide notice of dissenters' rights to the minority interest holders before the shareholder meeting acting on the reverse stock split proposal; pay the cost of an independent third party appraisal of the shares if the Bank and any dissenting shareholders are unable to agree on the value of the dissenting shares; and pay the cost of a binding arbitration by an independent third party, if the court that would ordinarily hear an appraisal action under the corporate governance procedures refuses jurisdiction to appraise the shares of a national bank.

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<sup>18</sup> 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).

<sup>19</sup> See *Teschner v. Chicago Title & Trust Co.*, 322 N.E.2d 54, 58 (Ill. 1974).

<sup>20</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), and 215a(b)-(d).

The dissenters' rights for Bank shareholders will afford comparable protections to the dissenters' rights provisions in the National Bank Act. Under both provisions, a minority shareholder in a reverse stock split 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 Texas law) or the Comptroller (under the National Bank Act) ultimately determines the fair value of the shares. If the state court that would ordinarily hear the appraisal action refuses jurisdiction in the matter, the Bank will pay the costs of a binding arbitration by an independent third party.



## **Conclusion**

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 Texas law.
2. The Bank will provide for dissenters' rights comparable to those found in 12 U.S.C. §§ 214a, 215, and 215a.
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 also should include a statement that the change in the capital structure complies with all applicable laws and regulations. Upon receipt of the notification, the OCC will review the reduction in capital attributable to the payment for 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 Pansy Hale, Licensing Analyst, Licensing Operations/Southwestern District, at 214-720-7052 .

Sincerely,

**-signed-**

Steven J. Weiss  
Deputy Comptroller  
Licensing Department