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U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

What Is Subrogation?

Subrogation is the substitution of one person in the place of another in connection with a lawful claim. Most insurance policies will include a provision that allows an insurance company, after it has paid a loss, the right to recover the amount paid out from the party that is responsible for the loss. This is referred to as the right of subrogation. Insurance companies generally have the right to step into the shoes of the party it compensates and then pursue the party that the compensated party could have pursued. The right of subrogation is utilized by insurance companies to recover from the party causing a loss under their policies to pay for property damage or casualty losses of their insureds. Most often the right of subrogation appears in leases, but it may also be found in mortgages and guarantees. The right of subrogation arises when a person has an obligation to pay the debt of another. For instance, if a person was the guarantor of a loan secured by real estate and the guarantor paid the loan, the guarantor would have the right to foreclose on the real estate to the same extent as the lender of the note. Leases will frequently contain a provision whereby the landlord and tenant waive the rights of recovery against one another to the extent that a loss is covered by insurance, or alternatively, agree to obtain insurance policies which the insured's company waives the right of subrogation that it may have against either the landlord or the tenant. Before a person signs an agreement containing a waiver of subrogation, it is important to first check with the insurance company to make sure that the terms of the insurance policy are not being violated. If the insurance policy does not permit a waiver of subrogation, it would be necessary to obtain an endorsement to the policy. Without a waiver of the right of subrogation, an insurance company paying a claim for damage to the landlord's property caused by a tenant, could pay the landlord for the value of the damage and then sue the tenant because the insurance company is subrogated to the landlord's claim against the tenant. There are advantages and disadvantages to allowing waivers of subrogation which should be carefully reviewed on a case by case basis.

State Regulation of National Banks

The Office of the Comptroller of the Currency ("OCC") has issued Advisory Letter AL 2002-9 in which the OCC sets forth its authority for the regulation of national banks. The advisory letter urges state governmental officials to contact the OCC in the event a national bank may be violating applicable state law or if the state authority seeks information concerning a national bank's operations. The OCC will then review the information provided by the state authority

and take such action as may be appropriate. In addition, national banks are informed to contact the OCC in the event that they are contacted by a state authority seeking information from the bank that may constitute an attempt to exercise authority or enforcement over the bank. The advisory letter indicates that the OCC has exclusive authority over national banks. The advisory letter is available on the web site of the OCC at www.occ.treas.gov.

Subchapter S Corporations

The Office of the Comptroller of the Currency ("OCC") has recently issued Advisory Letter AL 2003-1 in connection with national banks seeking to qualify as a Subchapter S corporation for federal tax purposes. As a condition of being a director of a national bank, a person must own a qualifying equity interest of either the national bank or its holding company. To qualify as a Subchapter S corporation, a corporation can have no more than 75 shareholders. In order to limit the total number of shareholders, the qualifying shares held by a director are sometimes subject to buy-sell agreements that require the director to sell back his shares on specified terms upon ceasing to be a director. Under Subchapter S of the Internal Revenue Service ("IRS") code, a corporation may have only one class of stock outstanding. A Subchapter S corporation is treated as having only one class of stock outstanding if all of the shares confer identical rights to distribution and liquidation proceeds. A bona fide buy-sell agreement is generally disregarded for purposes of determining whether a corporation's outstanding shares confer identical rights to distribution or liquidation proceeds. However, a buy-sell agreement is not disregarded if, among other things, the agreement establishes a purchase price that, at the time of the agreement is entered into, significantly deviates from the fair market value of the stock. In IRS Private Letter Ruling 2002-17-048, the IRS stated that buy-sell agreements that provide for a purchase or redemption of stock at book value or at a price between fair market value and book value may not be considered to establish a purchase price based on fair market value. As a result, buy-sell agreements which contain a repurchase provision significantly in excess of or below the fair market value or which causes a director to assign to the corporation all dividends or other distributions on his shares may create a separate class of stock and disqualify the corporation from Subchapter S treatment. The Advisory Letter is available on the web site of the OCC at www.treas.gov. and the IRS Letter is available on the web site of the IRS at www.irs.gov. As a side note, it is expected that Congress will consider legislation during the coming year which will permit Subchapter S corporations to have a maximum of 150 shareholders.

Cases, Releases and Rulings

The Financial Accounting Standards Board ("FASB") has published Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. The interpretation explains the existing disclosure requirements for most guarantees including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its financial statements. The interpretation may be obtained by placing an order on the web site of the FASB at www.fasb.org.

In Owen v. Kesser , case nos. 01-P-32 and 01-P-184 (2002), the Massachusetts Court of Appeals held that the seller had the right to cancel a property sales contract when the buyer's delivery of the contract was 20 minutes late because the contract specified that time is of the essence and it was to be

delivered by the buyer by a specified time and date.