

UPDATE

News of Developments in the Financial Sector and Related Areas

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Payment of Franchise Taxes by National Banks

In a recent Interpretive Letter, the Office of the Comptroller of the Currency ("OCC") concluded that a national bank had the authority to decrease the par value of its shares to \$.01 per share in order to pay the minimum franchise tax under Arkansas law. Section 52 of The National Bank Act provides that capital stock shall be divided into shares of \$100 each or such lesser amount as provided in the articles of association of a national bank. Assuming that a national bank had 50,000 shares of stock outstanding at a par value of \$100 per share and all of its assets were in Arkansas, the bank would pay an annual franchise of \$13,500. By amending the Articles to provide for a par value of \$.01 per share the bank would only pay the minimum annual franchise of \$50.00.

Covenants Not to Compete

Statco Wireless v. Southwestern Bell Wireless, 2003 Ark. App. LEXIS 31 (2003) is a decision by the Court of Appeals of Arkansas

upholding a covenant not to compete. Southwestern Bell Wireless ("Southwestern") is in the business of selling cellular phone service and Statco Wireless ("Statco") entered into an agency agreement with Southwestern for the sale of cellular phone service in return for the payment of commissions. The agreement between the parties contained a covenant not to compete in which Statco promised that for one year following termination of the agreement it would not induce customers to choose the services of a Southwestern competitor nor would it otherwise sell or promote services offered by competitors of Southwestern. For a covenant not to compete to be enforced, the Court noted the three requirements which must be met: (i) the covenantee must have a valid interest to protect; (ii) the geographical restriction must not be overly broad and (iii) a reasonable time must be imposed. Statco did not challenge the geographic or time restrictions in the covenant, but argued that Southwestern had no valid interest to protect, the covenant was overly broad and there was a lack of consideration for the covenant. The Court held that Southwestern had a valid interest in protecting the confidential information contained in its customer lists, agent compensation plans and bid proposals that Statco had access to during the time of its agency agreement. The Court went on to hold that the covenant was not overly broad because Southwestern was protecting its interests by (i) keeping its customers from being appropriated by Statco; (ii) keeping confidential information possessed by Statco from following into the hands of a competitor; and (iii) protecting its name, goodwill and assets. A judge who disagreed with the outcome in this case argued that the covenant should not be enforced since it did not involve the sale and purchase of a business. This case provides a good

background of decisions by the Arkansas Courts relating to covenants not to compete.

State Regulation of National Banks

The Office of the Comptroller of the Currency ("OCC") issued Advisory Letter AL 2002-9 which reflects the position of the OCC that it has exclusive authority over national banks. The Advisory Letter informs national banks to consult with the OCC in the event a state authority seeks the enforcement of state laws over a national bank. The OCC has also issued a proposal to amend 12 CFR 7.4000 which would clarify that the OCC has sole authority over national banks. The proposal does allow courts to require national banks to produce witnesses or information, however the exception for courts does not permit a state to inspect, regulate, or supervise national banks. The North American Securities Administrators Association has requested that the proposal by the OCC be modified to clarify that state securities regulators have the authority to investigate national banks and their affiliates in connection with securities or securities transactions. The National Association of Attorneys General in a letter to the OCC takes the position that the proposal misinterprets the National Bank Act. A number of letters from state banking agencies have requested that the proposal be withdrawn. Depending on if a final rule is adopted by the OCC, there may be a test case regarding the exclusive authority of the OCC over national banks.

Cases, Releases and Rulings

As a result of the adoption by the Federal Deposit Insurance Corporation of a final rule allowing state chartered banks to be chartered as limited liability companies for purposes of obtaining deposit insurance coverage, Nebraska has passed legislation permitting state banks to be chartered as a limited liability company. Nevada, Texas, New Hampshire, Vermont and Maine also permit banks to be organized as limited liability companies and a number of states are

considering similar legislation. At the present time banks chartered as limited liability companies would not qualify for partnership tax treatment under Internal Revenue Service regulations.

In a recent Interpretive Letter No. 954, the Office of the Comptroller of the Currency ("OCC") concluded that a mortgage subsidiary of a national bank which makes real estate – secured loans to residents of most states could impose the interest rates permitted by the state where the main office of the national bank is located. Both the national bank and the subsidiary were headquartered in Michigan and the OCC concluded that the subsidiary had the authority to export Michigan's interest rate for real estate – secured loans made by the subsidiary to residents of states other than Michigan or secured by real estate located in states other than Michigan.

Charles Schwab Corporation announced in a press release that it was entering the home mortgage business through its newly approved Charles Schwab Bank offering to beat any competitor's total price by \$100 and giving customers \$500 if it failed to do so and making a decision on a loan application within 24 hours or paying the applicant \$250.

In Interpretive Letter No. 956, the Office of the Comptroller of the Currency ("OCC") concluded that a national bank could take a share of the borrower's profits as part of the interest on loans made by the bank to the borrower based on OCC Interpretive Ruling 7.1006 which provides that a national bank may take as consideration for a loan a share in the profit, income or earnings from a business enterprise of a borrower. The OCC also concluded that it was permissible for a national bank to provide office space and pay a portion of the operating expenses of persons not employed by the bank for originating loans in lieu of a per-loan fee.

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