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UPDATE

News of Developments in the Financial Sector and Related Areas

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What Are Preemptive Rights?

Preemptive rights are generally referred to as the rights of existing shareholders to maintain their percentage of ownership of a company by having the right to buy a pro rata number of shares of any future issuances of common stock. Preemptive rights are often bargained for by investors, but usually are not contained in the articles of incorporation of a company. However, if preemptive rights are contained in the articles of incorporation, this provision can only be eliminated by a vote of the shareholders. If a company offers more of its stock, shareholders having preemptive rights are afforded the right to buy the shares to keep their percentage of ownership the same. By having preemptive rights, shareholders can maintain their voting control and share of earnings. However, preemptive rights complicate financing. By forcing a company to offer its shares to existing shareholders before it offers the shares to outside investors, these rights can postpone or effectively eliminate the sale of shares by a company to outsiders. Preemptive rights can also delay funding by an investor by requiring the company to first offer the shares to existing shareholders, creating a barrier to obtain financing by a company. Companies needing adequate financing and having to raise additional capital should consider eliminating preemptive rights in the event such rights exist in the articles of incorporation of the company.

Hedge Funds

The Securities and Exchange Commission ("SEC") has adopted a new rule which will require hedge fund advisers to be registered under the Investment Advisers Act of 1940 no later than February 1, 2006. The new rule is the result of a review begun by the SEC in 2003 of the structure, operation and compliance activities of hedge funds, marketing issues and investment protection issues. It is estimated that approximately 40 to 50 percent of all hedge fund advisers are currently registered with the SEC. The rule will also affect the way that hedge funds count their clients. A hedge fund adviser that has 14 or few clients and does not hold itself out to the public as an investment adviser does not have to register. Under the old rule, an investment fund adviser could count each hedge fund, which may contain a number of investors, as a single client. The new rule will require hedge fund advisers to look through the funds and count the number of investors in each fund to determine the eligibility for the exemption. A hedge fund is defined as a fund which is managed aggressively to get maximum rates of returns by using derivatives and swaps, selling short and using arbitrage techniques. A hedge fund

will generally be organized as a limited partnership or a limited liability corporation. Unlike mutual funds, hedge funds are generally not registered under federal securities laws. Depending on the sophistication and type of an investor in a hedge fund, a filing may be required under the applicable provisions of the Arkansas Securities Act.

Save Money on Franchise Taxes

Act 94 of 2004 ("Act 94") amended the *Arkansas Franchise Tax Act of 1979* to increase the annual franchise taxes effective for calendar years beginning January 1, 2004. Corporations, bank holding companies and banks (both state and national) organized under the laws of the State of Arkansas will want to consider amending their articles to provide for a par value of $.01 for each share of authorized stock. Bank holding companies and banks in Arkansas generally have a par value of $10.00 per share. Assuming that a corporation or bank had 500,000 shares of stock outstanding at a par value of $10.00 per share and all of its assets were in Arkansas, a corporation or bank would pay an annual franchise tax of $15,000.00 under Act 94. By amending the articles to provide for a par value of $.01 per share, the corporation or bank would only pay the new minimum annual franchise tax of $150.00, formerly $50.00 prior to Act 94. A corporation or bank would not want to amend its articles to provide for no par value since shares without par value are assessed at a rate of $25.00 per share, which if 500,000 shares were outstanding, would result in an annual franchise tax of $37,500.00 under Act 94. In Letter No. 963, the Office of the Comptroller of the Currency concluded, in response to a request by our law firm, 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.

Cases, Releases And Rulings

The Financial Accounting Standards Board has published FASB Statement No. 123 (Revised 2004), entitled *Share-based Payment*, which covers a wide range of share-based compensation arrangements, including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. The compensation costs relating to share-based payment transactions must be recognized in financial statements with the cost being measured based on the fair value of the equity or liability instruments issued. Public entities (other than those filing as small business issuers) will be required to apply the revised Statement as of the first interim or annual reporting period that ends after June 15, 2005. Public entities filing as shall business issuers will be required to apply the revised Statement in the first interim or annual reporting period that begins after December 15, 2005. Nonpublic entities will not be required to apply the revised Statement until the beginning of the first annual reporting period after December 15, 2005.

American Bankers Association v. National Credit Union Administration, 2004 U.S. Dist. Lexis 24730, is a recent case decided by the United States District Court for the District of Utah, Central Division, seeking invalidation of a decision by the National Credit Union Administration ("NCUA") which allowed a credit union to expand its geographic charter from a single county to a six-county area with plaintiff banks asserting that the six-county area did not represent a *well-defined local community* as required by federal law. The United States District Court remanded the matter back to the NCUA for further analysis on whether the six-county area constituted a "local" community within the parameters of the NCUA regulations.

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