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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Preemption of State Law

The Federal Deposit Insurance Corporation ("FDIC") held a public hearing in May of this year on a preemption petition from the Financial Services Roundtable ("Round-table"), a trade association for integrated financial services companies. The Round-table requested the FDIC to issue a rule that a state bank's home state law govern its interstate activities and those of its subsidiaries to the same extent that the National Bank Act governs a national bank's interstate business. In January 2004, the Office of the Comptroller of the Currency ("OCC") issued two final regulations relating to the preemption of state laws by federal banks over national banks. These two final regulations by the OCC have been contro-versial with state regulatory authorities, particularly in the area of preemption of corporate subsidiaries of national banks and the applicability of preemption of state laws relating to these corporate subsidiaries. The Roundtable is of the position that the adoption of a similar rule by the FDIC will create parity between state-chartered banks and national banks with interstate activities and operations. Subsequent to the public hearing, a conflict developed between the FDIC and the OCC regarding the authority of the FDIC to promulgate a rule which would, in essence, work like a wild card for state chartered banks in providing them with parity with national banks. The Chairman of the FDIC is of the position that the FDIC should do everything to protect a dual banking system, while at the same time the Office of the Comptroller of the Currency is of the position that the FDIC does not have the authority to preempt state law for state banks. The staff of the FDIC has been directed to draft a proposed rule and make it available for public comment. Because of the disagreement between the OCC and the FDIC, it does not appear that a rule will be adopted in the near future.

May Directors Vote by Proxy?

From time to time the question arises as to whether or not a director of a corporation may vote by proxy at a meeting of the board of directors due to circumstances such as being out of town, illness or incapacity. A *proxy* is basically a written authorization directing another person to act in his or her place at a meeting. Proxy voting by shareholders in a corporation is a well recognized practice, primarily due to geographical limitations, allowing share-holders to vote at a meeting of a corporation on such matters as the election of directors and changes in common or preferred stock. Absent statutory authority for proxy voting by directors, the general rule is that directors may not vote by proxy because they have a fiduciary duty to the corporation and its shareholders. Once elected, directors become fiduciaries, which means that they hold a special level of trust and confidence to the corporation and its shareholders. This fiduciary duty may not be delegated to others. Directors have basically two primary duties consisting of (i) duty of care and (ii) duty of loyalty. The duty of care means that directors must be diligent and careful in performing the duties they have undertaken on behalf of the corporation and its shareholders. This duty of care, which is sometimes referred to as due diligence, means that directors should attend and participate in board meetings in order for them to be informed about the corporation's business. In addition, this duty of care means that they must make reasonable inquiry before making a decision. This duty of care also requires them to manage corporate affairs honestly and in good faith, using the level of care that a reasonable prudent person would use under the same given circumstances. The duty of loyalty means that directors must act in the best interest of the corporation and its shareholders at the expense of their own personal interests, thus prohibiting directors from profiting at the corporation's expense in transactions involving the corporation and its assets. Because a director has the fiduciary responsibility for acting (i) in the best interest of the corporation, (ii) as an ordinarily prudent person would act, and (iii) only after reasonable inquiry, a director may not vote by proxy. However, it has become a generally accepted practice for directors to vote by telephone, so long as everyone present at a meeting can hear each other.

Cases, Releases and Rulings

The third annual study conducted by Foley & Lardner LLP on the costs associated with corporate governance reform shows that the average cost of being public in 2004 increased 33 percent over 2003 for a company with annual revenue under $1 billion. Audit fees accounted for the largest out-of-pocket cost increases, with average audit fees for public companies with less than $1 billion of annual revenues increasing 96 percent. The study attributes this increase to the phase-in of Section 404 of the Sarbanes-Oxley Act. Foley & Lardner's study found that the average cost of being public has increased 223 percent for public companies with under $1 billion in annual revenue since the enactment of the Sarbanes-Oxley Act. Companies responding to the survey conducted by Foley & Lardner indicated that the dynamic between public companies and their auditing firms has shifted dramatically from strategic business consultant to that of a vendor or even adversary. In addition, 20 percent of companies responding to the survey indicated that they were considering going private as a result of corporate governance costs.

BankWest, Inc. v. Baker, No. 04-12420, is a recent interesting decision by the United States Court of Appeals for the Eleventh Circuit, holding that Georgia's law limiting rates that may be charged by Georgia agents of out-of-state banks is not preempted by the Federal Deposit Insurance Act ("FDIA") which allows a state bank to charge any interest rate that may be charged in its home state. The Georgia law applied to payday loans, which carry an annual percentage rate of as high as 500 percent. Georgia lenders are prohibited from making these loans, but had attempted to avoid the prohibition by becoming agents of out-of-state banks and relying on the FDIA preemption. The Georgia law prohibited agents of out-of-state banks from making the payday loans when the agent would receive more than 50 percent of the loan profits. The Court held that the Georgia law was not preempted by the FDIA interest rate rule because it was a limitation on the agreement between the agents and the out-of-state banks and not on the interest rate that could be charged by a bank.

 Comments, ideas, opinions and questions - email gbinns@ddh-ar.com - telephone (501) 375-9151 - facsimile (501) 372-7142.