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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Treasury Stock

Arkansas has two Business Corporation Acts. Although they are somewhat similar, there are material differences between the two Acts. The Business Corporation Business Corporation Act (the "New Act") that became effective on January 1, 1988, did not amend or repeal any provision of law under the Arkansas Business Corporation Act which was in existence prior to 1988 (the "Old Act") and which continues to be in existence today. Companies organized under the Old Act can elect to be governed by the new Act. The New Act is derived primarily from the American Bar Association's 1984 Revised Model Business Corporation Act, but also includes a number of provisions of Delaware law relating to indemnification of officers and directors.

Treasury stock is generally referred to as stock which has been issued by a company to stockholders and thereafter acquired by the company from its stockholders. Under the Old Act, shares acquired by a company of its own stock are treated as treasury stock. Treasury shares are not permitted under the New Act, since shares acquired by a corporation of its own stock constitute authorized but unissued shares. In other words, under the New Act the acquired shares are treated as if they had never been issued.

A company will acquire its own stock for a number of reasons including, but not limited to:

- To help its stockholders get a better price for their shares.
- To be reissued to employees as compensation.
- To help maintain a market for its shares.
- To avoid a hostile takeover.

Assuming the shares are not cancelled or retired under the Old Act, treasury shares acquired by a company are recorded at cost. When treasury stock is retired by a company, the stock reverts to authorized by unissued shares. Depending on the circumstances, a filing under the Arkansas Securities Act (the "Act") will generally be required to be made and obtained prior to the issuance of authorized but unissued stock to a purchaser. In the event a filing is not made, the company may be liable under the Act to a purchaser of the stock for the principal investment plus 6% interest and any expenses incurred by the purchaser. Some companies mistakenly believe that if the proper filing has been made in connection with the original issuance of authorized but unissued shares that no subsequent filings under the Act are required relating to the sale of treasury stock. A company would need to make the proper filing for the sale of treasury stock in order to avoid the liability provisions of the Act. For purposes of the filing requirements of the Act, treasury stock is treated the same as authorized but unissued stock which has never been issued to stockholder.

Preferred Stock

In recent years bank holding companies and other financial institutions have become one of the largest issuers of preferred stock. The issuance of traditional preferred stock by a bank holding company will normally qualify as tier 1 capital. There are basically four types of preferred stock: (i) cumulative preferred, (ii) noncumulative preferred, (iii) participating preferred, and (iv) convertible preferred. Preferred stock will generally pay dividends either as a percent of par value or a specific dollar amount and are paid quarterly. In most cases preferred stock does not have voting rights and dividends will be cumulative.

Preferred stock is senior to common stock but is junior to creditors and bondholders. It is not unusual for preferred stock to have a call provision that allows the issuer to call the shares at any time or after a specific period of time such as five years.

Preferred stock may be cumulative or noncumulative. Cumulative preferred stock allows the holder to obtain dividend payments which were not paid in a timely manner by the issuer. If the issuer misses one or more dividend payments, then the holder has the right to receive these missed payments before any dividends can be paid to the holders of the issuer's common stock. However, a holder of noncumulative shares does not have this right. In Interpretive Letter No. 1086, the Office of the Comptroller of the Currency authorizes a national bank to own fixed-rate cumulative preferred stock.

Participating preferred stock allows the holder to receive earnings over and above a specified dividend amount. Participating preferred stock is sometimes utilized as a poison pill in the event of an unwanted takeover by allowing the existing holders to buy more shares at a substantially reduced price.

Another form of preferred stock is known as noncumulative perpetual preferred stock. Noncumulative perpetual preferred stock may be an alternative to small bank holding companies. Although common stock should generally be the dominate form of capital for a bank holding company, noncumulative perpetual preferred qualifies as capital for bank holding companies.

Noncumulative perpetual preferred may be issued at both the bank holding company level and the bank level in order to increase capital. Because noncumulative perpetual preferred is considered a separate class of stock, Subchapter S corporations are not eligible since they can only have one class of stock.

Any redemption of noncumulative perpetual preferred is subject to regulatory approval. Noncumulative perpetual preferred has no voting rights and is perpetual, meaning that it has no final maturity date. Quarterly dividends are subject to board approval and are noncumulative if not paid. Dividends paid on noncumulative perpetual preferred stock are not a tax deductible interest expense.

Convertible preferred allows the holder to convert the shares into the issuer's common stock at a preset conversion price. Since convertible preferred stock allows for the opportunity for capital appreciation through the conversion into the issuer's common stock, the dividend will generally be lower than the dividend on non-convertible preferred stock.

Our firm is available to answer questions on the benefits of issuing preferred stock and the placement of it with local investors and third parties.

 Comments, ideas, opinions and questions - email gbinns@ddh-ar.com - telephone (501) 978-9923 - facsimile (501) 375-6484.