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U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Capital Through Private Placement of Securities

In the early 1900s, companies often sold securities on the basis of a promise of fantastic profits without disclosing any meaningful information to investors. These conditions contributed to the Stock Market Crash of 1929. As a result of the Stock Market Crash, the United States Congress enacted federal securities laws and created the Securities and Exchange Commission ("SEC") to administer them. Under federal law, the sale of securities is governed by the Securities Act of 1933 and other applicable federal laws. Every state also has its own securities laws, which are commonly known as "Blue Sky Laws" because their purpose is to prevent speculative schemes which have no more basis than so many feet of blue sky. Both federal law and state Blue Sky Laws require a company, as the issuer of securities, to make full disclosure of all material facts before offering securities for sale. Securities laws are designed to require companies to give investors full disclosure of all material facts in order for them to make an investment decision.

Because of the higher interest rate spreads on debt and noncumulative perpetual preferred securities with institutional purchasers, a bank holding company may want to consider the private placement of its equity, debt or hybrid (trust preferred and noncumulative perpetual preferred) securities with local investors such as board members, existing shareholders and major customers. Funds derived from the private placement of securities may be utilized for acquisitions, internal growth and increasing tier 1 capital.

Allowing the company to select investors with compatible goals and interests is one of the advantages of a private placement. Another advantage is they are less expensive and time consuming since a private placement does not require the assistance of an underwriter.

Although other exemptions from the requirements to register securities may be available, Sections 3(b) and 4(2) of the Securities Act of 1933 may be utilized in making a private placement with local investors. Section 4(2) of the Securities Act of 1933 exempts from registration "transactions by an issuer not involving a public offering." To qualify for this exemption, purchasers must:

- have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment or be able to bear the investment's economic risk;

- have access to the type of information normally provided in a prospectus, *i.e.*, an offering memorandum; and
- agree not to resell or distribute these securities to the public.

Section 4(2), often referred to as the *private offering exemption,* is one of the most frequently relied upon exemption in making private placements under the provisions of both state and federal law. This exemption has developed to include not only Section 4(2) transactions, but also transactions described in Section 3(b) [i.e., securities issued pursuant to regulations of the SEC in an aggregate amount not to exceed $5 million]. Sections 3(b) and 4(2) are the basis for SEC Regulation D, which is designed to permit the sale of securities to sophisticated investors, which are also known as accredited investors under Regulation D.

The enactment of Regulation D sets forth the requirements for a substantial portion of private offerings. A bank holding company as issuer still may claim an exemption under Section 4(2) even though the technical provisions of Regulation D are not fully met. Although an issuer may fully comply with the requirements of federal law relating to a private placement, it must also comply with any applicable state law relating to the offer and sale of its securities.

In connection with the sale of securities through a private placement, an offering memorandum should be prepared for purposes of disclosing to potential investors information on the company including background information on management, terms of the offering (including the number of shares available, the price and the intended use of the funds), capital structure of the company before and after the sale of the securities, the risks involved in the investment and financial statements of the company.

Our firm is available to answer questions on the benefits of issuing securities in a private placement with potential investors.

Save Money on Franchise Taxes

Act 94 of 2003 ("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 Interpretive 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.

Arkansas has two Business Corporation Acts. Although they are somewhat similar,

there are material differences. In making amendments a corporation needs to be careful in selecting the correct Act.