Garland W. Binns, Jr.
Dover Dixon Horne PLLC
Attorneys at Law
425 West Capitol, Suite 3700
Little Rock, Arkansas 72201
Telephone: (501) 978-9923
Facsimile: (501) 375-6484
Email: gbinns@ddh-ar.com
Web Site: www.GWBinns.com

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U P D A T E

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Directors and Officers Liability Insurance

Directors and officers liability insurance coverage ("D&O") is designed to protect the personal assets of directors and officers commonly referred to as insured persons of an institution against *losses* arising from *wrongful acts* and *claims* against them. *Losses* are generally defined in a D&O policy to include defense costs, judgments and settlements which an insured person may incur in serving as a director or officer of an institution. *Wrongful acts* generally include alleged omissions, misleading statements, neglect or breach of fiduciary duties in the discharge of duties as an officer or director of an institution. *Claims* are generally defined to include written demands, civil and criminal proceedings, arbitrations, administrative and regulatory proceedings and investigations.

The preferable coverage for D&O coverage is one where the insurer has the duty to defend the claim. Otherwise the insured is responsible for obtaining its own defense counsel and then having to obtain reimbursement from the insurance company for its costs and expenses.

It is important to determine in connection with indemnification of officers and directors if the institution has adopted indemnification protections in its articles of incorporation, by-laws or other corporate documents whereby the institution will reimburse its directors and officers for expenses or damages incurred for claims brought against them. Otherwise, the director or officer may not be entitled to indemnification once a claim is made against them.

D&O policies are claims made policies which mean that they cover claims made only during the existence of the policy period regardless of whether the alleged wrongdoing occurred during or before the policy. As a result it is important for institutions to maintain D&O coverage after a director's or officer's service ends.

There are three types of D&O coverage available. The first is known as "Side A" which provides coverage on those claims made against individual directors and officers for losses that are not indemnified by the institution. The second is referred to as corporate reimbursement or "Side B" coverage which provides reimbursement for those amounts the institution incurs in its indemnification of claims brought against its directors and officers. The third is referred to as "Side C" which provides coverage when the institution itself is the subject of a claim as in the case of securities violations.

Although the forms of coverage will be generally contained in the same policy, each is separate and distinct and may be subject to different deductibles and exclusions.

It is important to understand the difference between derivative actions versus third-party actions. Derivative actions are actions in the name and on behalf of the institution and in the event of recovery, the amount of the recovery goes to the institution. A director's and officer's right to be indemnified in connection with a derivative action is more limited than the right to be indemnified with respect to third-party actions. With respect to third-party actions, the institution may indemnify directors and officers against defense costs, judgments and amounts paid in settlement in those cases where the person acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the institution, and in regard to criminal actions, the director or officer had no reasonable cause to believe that his conduct was unlawful.

Because the institution may not indemnify a director or officer in a derivative action or if the institution is financially unable or has failed, it is important for directors and officers to address the need for Side A coverage. In most instances, there is not a deductible in policies providing Side A coverage. Directors and officers need to be aware of the limits for liability under Side A, Side B and Side C policy coverage.

It is important for institutions to provide indemnification of directors and officers in their governing instruments and to maintain adequate insurance coverage to afford protection from directors and officers having to use their own resources to bear the costs for any claims. D&O policies should be carefully reviewed to ensure that they provide the broadest protection for the personal resources of individual directors and officers. Our firm is available to assist and answer questions involving D&O coverage.

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.

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Arkansas has two Business Corporation Acts. There is the Arkansas Business Corporation Act of 1965, and there is the Arkansas Business Corporation Act of 1987. Although they are somewhat similar, there are material differences. In making amendments, a corporation needs to be careful in selecting the correct Act.

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