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ATTORNEY GENERAL OPINION NO. 82-196

John A. O'Leary, Jr.
State Bank Commissioner
818 Kansas
Topeka, Kansas 66612

Re: Banks and Banking -- Bank Holding Companies --
Definition of Bank Holding Company

Synopsis: The participation of Fourth Financial Corporation in the ownership of Coffeyville Bancshares, Inc., a company which is to own all of the voting shares of the First National Bank of Coffeyville, will not, as a matter of law, render Fourth Financial Corporation a "bank holding company" within the meaning of K.S.A. 9-504(a). Such participation will not afford Fourth Financial Corporation any legal right to directly or indirectly own, control or hold with power to vote 25% or more of the voting shares of said bank, and it will have no legal basis for controlling in any manner the election of a majority of the bank's directors. Cited herein: K.S.A. 9-504, 9-505c, 77-201.

* * *

Dear Commissioner O'Leary:

You have requested our advice on the proposed acquisition of the First National Bank of Coffeyville, Kansas (hereafter referred to as "First National") by Coffeyville Bancshares, Inc. (hereafter referred to as "CBI"). Specifically, you have asked whether such acquisition would offend the Kansas bank holding company statutes (K.S.A. 9-504 to 9-595c, inclusive).-

In view of our recent opinion (No. 82-195) regarding the applicability of these statutes to the application for a national bank charter in Garden City, Kansas, we think it unnecessary

to reiterate much of what we said there regarding the federal Bank Holding Company Act (BHCA) and its comparability to our statutes. Suffice it to state that, in our judgment, even though our statutes were originally patterned after the BHCA, subsequent amendments to the BHCA have established distinctive requirements and presumptions in the BHCA which are not present in our statutes. Thus, to the extent that the administrative and judicial interpretations of the BHCA and the rules and regulations adopted by the Federal Reserve Board thereunder involve application of these distinctive federal provisions, we do not believe such interpretations to be persuasive to our construction of the Kansas statutes.

In addition, it is appropriate to repeat the caveat entered in our previous opinion, that our consideration of inquiries of this type must necessarily be limited to questions of law. Our opinions must be predicated on an established set of facts, since the application of the same legal principles to differing factual circumstances may produce opposite conclusions. As state bank commissioner, you have the responsibility for determining the facts essential to the resolution of questions arising under our banking laws, and it is your obligation to make the requisite policy decisions as to the application of our laws to a given set of facts. Hence, we trust that the statutory interpretations and legal principles enunciated in this opinion and in Opinion No. 82-195 will better enable you in the future to exercise your judgment regarding bank holding company questions involving the application of these interpretations and principles.

In this instance, it is our understanding that CBI has been formed as a Kansas corporation for the purpose of acquiring virtually all of the voting shares of First National. Thus, it is proposed that CBI will become a one-bank holding company. The question under this proposal arises from the fact that Fourth Financial Corporation (FFC), the parent corporation of the Fourth National Bank and Trust Company of Wichita, Kansas, will be a stockholder of CBI.

As disclosed by CBI's amended articles of incorporation and by its application to the Federal Reserve Board to acquire the common stock of First National, CBI has three classes of stock -- class A common, class B common and cumulative preferred. The shares of both classes of CBI's common stock are voting shares. An individual (hereafter referred to as "Stockholder") will own all 10,000 shares of class A common, while FFC will own all 3,330 shares of class B common. Thus, FFC will own 24.98% of the common stock of CBI.

FFC also is to own all of the 73,500 shares of CBI's preferred stock. With one exception, the preferred stock is nonvoting stock. The sole exception to the preferred stock's nonvoting

status is provided in CBI's amended articles of incorporation at paragraph (f) of Article Fourth, as follows:

"(f) While any preferred stock is outstanding, the Corporation, without first obtaining the consent, either expressed in writing or by the affirmative vote at a meeting called for that purpose, of the holders of at least a majority of the total number of shares of preferred stock then outstanding, shall not change or alter the rights, preferences, or privileges of the preferred stock."

Thus, as the sole preferred stockholder, FFC is entitled to exercise voting power with respect to such stock only if CBI proposes to "change or alter the rights, preferences or privileges of the preferred stock," and such voting power may be exercised only to approve or disapprove such proposal.

We also have reviewed the amended and restated stockholders' agreement entered into by FFC, Stockholder and CBI. The essential elements of this agreement are as follows:

- (1) FFC and Stockholder each agree to purchase their respective shares of common and preferred stock, as noted above;
- (2) FFC is provided an option for a period of ten years to purchase all of Stockholder's class A common stock, but such option is expressly conditioned on the legality of such purchase under pertinent state and federal laws, including the Kansas bank holding company statutes;
- (3) If FFC's option is not exercised within the prescribed time, Stockholder is provided a one-year option to purchase all of FFC's common and preferred stock;
- (4) FFC expressly recognizes that it is prohibited from taking any action which would constitute control of CBI within the contemplation of the Kansas bank holding company statutes;
- (5) In the event neither Stockholder nor FFC exercises its option to purchase the other's stock, both will "exert their best efforts" to cause CBI to sell First National and to be liquidated and dissolved; and
- (6) The transfer of CBI's stock held by either Stockholder or FFC is restricted. If either Stockholder or FFC proposes to dispose of any of its shares of stock, the other shareholder and the corporation are provided the right of first refusal at a specified price per share. FFC's present incapacity to

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acquire additional shares of voting stock is recognized by this provision. Further, in the event there is a proposed transfer of any of Stockholder's shares, FFC is given the right to offer to sell all of its common and preferred stock to Stockholder. If FFC is unable to either purchase the stock proposed to be transferred by Stockholder or to sell all of its stock to Stockholder, both FFC and Stockholder, upon FFC's request, shall jointly cause the assets of CBI to be sold and CBI liquidated. The agreement affords substantially the same powers to Stockholder.

Finally, we note from CBI's application to the Federal Reserve Board that FFC is the guarantor of CBI's purchase of stock from First National's existing stockholders. However, such guarantee does not vest in FFC any power to acquire such stock, in the event of CBI's default.

It is within this factual context that we have considered whether the arrangement described above results in FFC becoming a "bank holding company," as that term is defined in K.S.A. 9-504(a). Unless FFC satisfies the requirements of this definition, it is unnecessary to consider the proscriptions regarding bank holding companies in the succeeding statutes.

Under K.S.A. 9-504(a), a "bank holding company" is defined as meaning:

"any company: (1) Which directly or indirectly owns, controls, or holds with power to vote, twenty-five percent (25%) or more of the voting shares of each of two (2) or more banks or of a company which is or becomes a bank holding company by virtue of this act; (2) which controls in any manner the election of a majority of the directors of each of two (2) or more banks; or (3) for the benefit of whose shareholders or members twenty-five percent (25%) or more of the voting shares of each of two (2) or more banks or a bank holding company is held by trustees; and for the purposes of this act, any successor to any such company shall be deemed to be a bank holding company from the date as of which such predecessor company became a bank holding company. Notwithstanding the foregoing (A) no bank shall be a bank holding company by virtue of its ownership or control of shares in a fiduciary capacity, except where such shares are held for the benefit of the shareholders of such bank."

Essential to an understanding of this definition is the meaning of "company," which is defined in subsection (b) of that statute to mean

"any corporation, business trust, association, or similar organization, but shall not include: (1) Any corporation the majority of the shares of which are owned by the United States or by any state; (2) any corporation or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; or (3) any partnership."

By virtue of paragraph (1) of K.S.A. 9-504(a), a company is a bank holding company if it "directly or indirectly owns, controls, or holds with power to vote, twenty-five percent (25%) or more of the voting shares of each of two (2) or more banks." We are advised that FFC presently owns substantially more than 25% of Fourth National Bank and Trust Company of Wichita. Hence, if the proposal considered here results in FFC directly or indirectly owning, controlling or holding with power to vote 25% or more of First National's voting shares, FFC must be regarded as a bank holding company under our statutes.

From all of the documents provided us, it is clear that FFC will not directly own, control or hold with power to vote any of the voting shares of First National. All voting shares of First National are to be owned by CBI. There is nothing to indicate that any entity other than CBI will have any direct ownership of or control over these shares. Thus, under the facts set forth above, any ownership, control or power to vote FFC may have regarding First National's voting shares would be derived indirectly from its participation in CBI.

The proposal before us discloses four ways in which FFC is involved with CBI, i.e., (1) as holder of 24.98% of CBI's voting shares, (2) as holder of all shares of CBI's cumulative preferred stock, (3) as a party, along with Stockholder and CBI, to the stockholders' agreement discussed previously, and (4) as guarantor of CBI's purchase of stock from First National's existing stockholders. It is appropriate to consider each of these relationships to determine whether any of them by itself or all of them collectively provide FFC with indirect ownership, control or power to vote 25% or more

of First National's voting shares. In so doing, we have been guided by the conclusions reached in our previous opinion (No. 82-195), in which we considered whether a one-bank holding company's ownership of stock in a company which owned all of a bank's voting shares provided the existing one-bank holding company with indirect ownership or control of the bank's voting shares. In order to avoid unduly burdening this opinion, we invite your attention to the conclusions expressed in that opinion regarding the prerequisites for determining the existence for such indirect ownership or control.

Since all of First National's voting shares will be owned by CBI, the board of directors of CBI will exercise direct control over these shares. As holder of 24.98% of CBI's voting shares, with the remaining 75.02% of such shares owned by Stockholder, FFC does not own the shares of common stock necessary to elect a majority of CBI's directors. Hence, solely by virtue of its ownership of 24.98% of CBI's voting shares, FFC will not, as a matter of law, have any control over First National's voting shares.

We previously noted that the only voting power FFC has as the owner of all of CBI's preferred stock is to approve or disapprove any proposed change in the rights, preferences or privileges of the preferred stock. CBI's application to the Federal Reserve Board and its amended articles of incorporation both reflect a total capitalization for CBI in the amount of \$8,683,000. Of that amount, \$7,350,000 will be derived from FFC's purchase of preferred stock. Viewed from this perspective, it is apparent that CBI's amended articles of incorporation have afforded FFC, as sole preferred stockholder, a veto power respecting any change or alteration in the rights, preferences or privileges of the preferred stock which would impair its significant capital investment. However, FFC has no power to initiate any such change or alteration, and there is no provision in CBI's articles of incorporation for the conversion of preferred stock to common stock.

The rights and preferences of preferred stockholders are set forth in Article Fourth of CBI's Articles of Incorporation. In paragraph (b) thereof, these stockholders are entitled to receive an annual, cumulative dividend prior to any dividend being paid to common stockholders. And in paragraph (e) of this article, preferred stockholders are accorded first preference in the distribution of CBI's assets in the event of its liquidation. FFC's authority extends only to the preservation of these rights and preferences. As a matter of law, therefore, FFC's voting power respecting its preferred stock does not directly or indirectly affect CBI's ownership or control of First National's voting shares, or otherwise affect CBI's management prerogatives respecting First National.

Although the stockholders' agreement provides FFC with an option to purchase all of the class A common stock held by Stockholder, such option is expressly conditioned on the legality of such purchase under our bank holding company statutes. Hence, if these statutes are not amended so as to permit FFC's total ownership of First National's voting shares by virtue of its ownership and control of CBI, such option may not be exercised. With this limitation, there is no basis for concluding that this option has any legal effect on the management or control of CBI or its ownership of First National's voting shares.

Similarly, we do not find the "restrictive transfer" provision in the stockholders' agreement vests in FFC any right to control First National's voting shares. This provision is directed at the shares of CBI's various classes of stock held by Stockholder and FFC. Although it provides FFC a right of first refusal, in the event Stockholder proposes to transfer shares of class A common stock, and provides in the alternative an opportunity for FFC to sell all of its stock to Stockholder, FFC does not have the right to designate or approve the transferee in the event such transfer is permitted. Under these circumstances, we are unable to conclude as a matter of law that these contractual restraints on the transfer of Stockholder's shares of CBI provides FFC with any control over First National's voting shares.

At this point it is appropriate to note that there are a myriad of judicial definitions of "control." Each that we have reviewed is couched within the framework of a particular statutory provision or within the context of a particular set of facts, and we have discovered none which is precisely applicable to the situation considered here. Hence, as directed by established rules of statutory construction, we have accorded this word its plain and ordinary meaning. Lakeview Gardens, Inc. v. State, ex rel., Schneider, 221 Kan. 211, 214 (1976). See, also, K.S.A. 77-201, Second. Accordingly, we believe "control" within the context of K.S.A. 9-504(a)(1) means "to exercise restraining or directing influence over." Webster's Third New International Dictionary (1968), p. 496.

Thus, in considering the restrictive transfer provision with respect to the definitional requirement in K.S.A. 9-504(a)(1) that a company must control more than 25% of the voting shares of each of two or more banks, we do not find this contractual provision to have created a legal right in FFC "to exercise restraining or directing influence over" First National's voting shares.

However, two other provisions of the stockholders' agreement appear to have a direct impact on First National's voting shares, to wit: (1) If neither Stockholder nor FFC exercises

its options under the agreement, the parties agree to cause CBI to sell First National and to be liquidated and dissolved; and (2) under the "restrictive transfer" provisions of the agreement, if the proposed transfer cannot be made and the various alternative stock dispositions cannot be effected, there is agreement to cause the assets of CBI to be sold and CBI liquidated, if either of the shareholders objects to the transfer and requests such action.

In Attorney General Opinion No. 82-195, we noted that the Kansas bank holding company statutes were patterned after the Bank Holding Company Act of 1956 (BHCA). And even though the federal and Kansas statutes reflect different regulatory philosophies (i.e., the BHCA regulates both single and multi-bank holding companies, while Kansas merely prohibits the latter), we believe it reasonable to assume that both Congress and the Kansas Legislature of 1956 were responding to the same issue. We also noted in our prior opinion that the problem sought to be controlled by Congress through the BHCA was the undue concentration of control of banking activities in those business entities that may be used as media for acquiring and maintaining in perpetuity management and control of bank shares or assets. Congress was concerned, in part, with the "concentration of commercial bank facilities in a particular area under a single control and management." 2 U.S. Code Cong. & Ad. News (1956), p. 2483. See, also, First Lincolnwood Corp. v. Board of Governors, 560 F.2d 258, 260 (7th Cir., 1977). We believe these authorities disclose an evident intent to regulate those companies which have the ability to govern or manage a bank's operations or assets by exercising a "restraining or directing influence over" the bank's voting shares.

In our judgment, therefore, the definitional requirements of K.S.A. 9-504(a) regarding control of a bank's voting shares should be viewed from the perspective of the problem sought to be remedied by the legislation. See, e.g., State, ex rel., v. Murphy, 183 Kan. 698, 702 (1958). Accordingly, we note that FFC's rights under the stockholders' agreement respecting First National's voting shares relate in each instance to CBI's ownership of these shares. However, it would not appear that any of these contractual provisions provide FFC with a "restraining or directing influence over" these shares, so as to permit FFC to govern or manage First National's operations or assets. In fact, we believe it would be appropriate for you to conclude that FFC's contractual authority to cause CBI's dissolution and liquidation, thereby causing CBI to dispose of First National's voting shares, is clearly consonant with the legislative objective underlying the bank holding company statute, i.e., to preclude the perpetual corporate management of bank shares and assets.

Here, we believe the questions for your determination are whether FFC's contractual rights foster the perpetual management and control of these shares or the assets of First National, or do they promote an undue concentration of commercial bank facilities under a single control and management. We believe the facts presented here would warrant your negative answer to these questions and a conclusion that FFC's exercise of these contractual prerogatives would mitigate, rather than enhance, the possibility for perpetual corporate management and control of First National's shares and assets.

As to FFC acting as guarantor for CBI's purchase of stock from First National's existing stockholders, we noted previously that FFC has no authority as guarantor to acquire such stock in the event of CBI's default. A default affecting FFC's liability as guarantor would be the consequence of CBI's under capitalization by reason of Stockholder's failure to pay for subscribed shares of CBI's class A common stock. Thus, FFC would be left to pursue its legal remedies against Stockholder, and under such circumstances, there is no basis for concluding that, as a matter of law, FFC would directly or indirectly own, control or hold with power to vote First National's common stock.

Based on the foregoing conclusions, therefore, it is our opinion that FFC will not, as a matter of law, indirectly control 25% or more of the voting shares of First National. That is, whether considered separately or collectively, FFC's ownership of CBI's common stock, its voting power respecting its preferred stock of CBI, its rights and powers under the stockholders' agreement and its guarantee of CBI's purchase of First National's voting shares do not, in our judgment, provide FFC with any legal right to exercise a restraining or directing influence over the management and control of First National. Thus, it is our opinion that FFC is not a "bank holding company" pursuant to the provisions of K.S.A. 9-504(a)(1).

We have reached a similar conclusion regarding the provisions of paragraphs (2) and (3) of K.S.A. 9-504(a). Considering these in reverse order, we note that the proposal before us does not involve companies whose shares are held by trustees. Hence, paragraph (3) has no application to our analysis.

K.S.A. 9-504(a)(2) provides that a company is a "bank holding company" if it "controls in any manner the election of a majority of the directors of each of two (2) or more banks." We previously stated that, as sole stockholder of First National, CBI controls the election of the entire board of directors of First National. Such control is exercised through CBI's board of directors, and our previous discussion herein has indicated that FFC does not own sufficient voting

stock in CBI to elect a majority of CBI's directors. Further, our previous analysis also reflects that FFC will not have any legal basis for indirectly controlling CBI's directors with respect to their control of First National's voting shares. Accordingly, it is our opinion that FFC has no legal basis under the proposal considered here for controlling in any manner the election of a majority of First National's directors.

Before concluding, it is important to reiterate that we necessarily have confined this opinion to questions of law which are attendant upon the facts presented to us. Thus, we have limited our opinion to a consideration whether Fourth Financial Corporation, under the proposed acquisition of the voting shares of the First National Bank of Coffeyville, has any legal right or basis for owning, controlling or voting 25% or more of these shares or controlling the election of a majority of the bank's directors. We have found no such legal right or basis, either by virtue of its ownership of stock in the bank's parent company, by virtue of guaranteeing the parent company's obligation or through its agreement with the parent company and its other stockholder. This is not to suggest, however, that it is not possible for Fourth Financial Corporation to exercise, in fact, the requisite control over the management and policies of the bank. This, of course, is a question of fact which cannot be resolved at this time, but as State Bank Commissioner, you have general supervisory power over the banking industry, and it is thus your prerogative to monitor the Fourth Financial Corporation's participation in the ownership of the bank holding company to assure that no violation of our bank holding company statutes occurs.

In summary, therefore, it is our opinion that the participation of Fourth Financial Corporation in the ownership of Coffeyville Bancshares, Inc., a company which is to own all of the voting shares of the First National Bank of Coffeyville, will not, as a matter of law, render Fourth Financial Corporation a "bank holding company" within the meaning of K.S.A. 9-504(a). Such participation will not afford Fourth Financial Corporation any legal right to directly or indirectly own, control or hold with power to vote 25% or more of the voting shares of said bank, and it will have no legal basis for controlling in any manner the election of a majority of the bank's directors.

Very truly yours,

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