

INTERPRETIVE LETTER 91-15 (JULY 8, 1991)

State bank may extinguish interests of minority shareholders by means of a reverse stock split or interim bank merger.

During our telephone conversation of last week, you inquired about this Office's position with respect to "reverse stock splits." You specifically inquired whether this Office had issued any Rules or interpretive letters on that subject.

This Office has not issued any Rules pertaining to reverse stock splits. A number of Illinois banks have been involved in reverse stock splits in recent years, and this Office has not found them to be illegal and has not offered an objection to the concept of reverse stock splits. While the Illinois Banking Act (Ill. Rev. Stat. 1989, ch. 17, par. 301 et seq.) does not expressly address reverse stock splits, a reverse stock split is in reality a series of charter amendments which can be carried out pursuant to Section 17 of the Act (Ill. Rev. Stat. 1989, ch. 17, par. 324). Of course, this series of charter amendments ultimately results in the ownership interest of minority shareholders being extinguished. Therefore, the charter amendments may be seen as contrary to the interests of minority shareholders. Corporate actions that are contrary to the ownership interests of minority shareholders are not, however, inherently illegal or so obnoxious that a regulator such as this Office must intervene to prohibit those corporate actions from occurring. The Illinois Supreme Court has stated that "in general...unless there is fraud which would entitle dissenting shareholders to other relief, interests of minority shareholders' can be terminated." Teschner v. Chicago Title and Trust Company, 59 Ill. 2d 452 (1975).

An alternative to a reverse stock split which also would result in the ownership interest of minority shareholders being extinguished is the "interim bank merger." An interim bank merger, again a legal corporate action, would result in a bank's minority shareholders either exchanging their shares of bank stock for shares of holding company stock or dissenting to the merger and "cashing out" their bank shares for fair value.

It is the position of this Office that the bank ownership interests of minority shareholders can legally be extinguished by means of either a reverse stock split or an interim bank merger. The reverse stock splits and interim bank mergers can serve legitimate corporate purposes, such as those suggested in Teschner: "[T]he corporate action of reclassifying stock and eliminating fractional shares was basically to reduce corporate expenses and simplify and facilitate procedures." Teschner, 59 Ill. 2d at 459.

It is also the position of this Office that the minority shareholders are not totally without any rights when a reverse stock split or interim bank merger is undertaken. However, the rights of the minority shareholders do not include an absolute right to remain shareholders. The rights of the minority shareholders include, rather, the right to reasonable and fair consideration in exchange for the property (i.e., the shares of stock in the bank) which they are parting with. This Office requires that any reverse stock split or interim bank merger involving a state-chartered bank must include an objective, independent analysis of the fair value of the shares of stock (i.e., an appraisal or fairness

opinion) which supports the price being offered to the minority shareholder for his or her shares of stock. If the minority shareholder remains unsatisfied with the offer made by the bank and a satisfactory offer cannot be negotiated, the minority shareholder may resort to litigation in order to challenge the reverse stock split or to have the fair value of his or her shares paid.