



pennsylvania
DEPARTMENT OF BANKING

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OFFICE OF CHIEF COUNSEL

March 2, 2007

[redacted]

Re: [redacted] Applicability of Section 112 of the Banking Code of 1965

Dear [redacted]:

This is in response to your letter to the Commonwealth of Pennsylvania Department of Banking (the "Department") in which you request that the Department revisit its stated position that [redacted] (the "Acquirer"), operating himself and through [redacted], [redacted], and [redacted] (together, the "Group"), was required to file an application and seek the written approval of the Department pursuant to Section 112 of the Banking Code of 1965 (the "Banking Code"), 7 P.S. § 112, prior to soliciting revocable proxies from more than 10% of the shareholders of [redacted] (the "BHC"), for purposes of withholding votes for two directors of the BHC at the BHC's February 9, 2007, annual meeting (the "Annual Meeting").

For the reasons set forth below, please be advised that the Department maintains its position that the Acquirer was required to receive the prior written approval of the Department pursuant to Section 112 of the Banking Code in order to solicit the revocable proxies used for purposes of withholding votes for two directors of the BHC at the Annual Meeting.

Factual Background

As a matter of background, the BHC is a mid-tier stock holding company which owns all of the outstanding stock of [redacted] (the "Bank"), a Pennsylvania state-chartered stock savings bank. [redacted], the parent of the BHC, owns 55% of the outstanding shares of common stock of the BHC. According to documents filed with the United States Securities and Exchange Commission (the "SEC"), the Group owns approximately 9.4% of the BHC's outstanding shares and the Acquirer has sole voting authority with respect to approximately 99.99% of those shares. See SEC Form DEFC14A, [redacted] (via EDGAR).

According to the SEC's EDGAR system, the proxy form employed by the Acquirer for the Annual Meeting was first definitively filed with the SEC on [redacted]. It was a revocable proxy issued to more than 10% of the shareholders of the BHC that requested the shareholders to vote as the Acquirer would be voting; namely, to withhold votes for the two directors of the BHC that

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were standing for election and for the ratification of the appointment of the BHC's independent auditors for 2007. Additionally, the proxy form gave the Acquirer the discretion to vote shares as he saw fit in the event other business should come before the meeting, with the caveat that the Acquirer would only vote on such matters unknown to the Acquirer a reasonable time before soliciting the proxy. Finally, in the event a shareholder would return the proxy form issued by the Acquirer signed but with no vote directed, the Acquirer would vote the proxy in his favor as indicated above.

Legal Analysis

Section 112(b) of the Banking Code provides in pertinent part that:

[e]xcept as provided in subsection (i), it shall be unlawful, without the prior written approval of the department pursuant to this section, for any person to acquire, *or to make a proposal to acquire*, shares of an institution or *shares of a corporation which controls an institution* if the aggregate number of shares held after such acquisition would total more than:

(i) ten percent of any class of the outstanding shares of such institution or corporation;

7 P.S. §112(b) (emphasis added). The following pertinent definitions apply to the key terms used in Section 112(b) of the Banking Code:

(i) "Acquire"-- obtaining legal or beneficial ownership of shares, *or voting rights of shares, whether obtained directly or indirectly, through an intermediary or otherwise*; beneficial ownership by a person shall be deemed to include ownership by another person which controls, is controlled by or is under common control with such person and to include ownership by a spouse or member of the family of such person; the acquisition of options, warrants and rights to subscribe for, or to purchase, shares and the acquisition of rights to obtain shares through conversion or exchange shall be deemed an acquisition of such shares.

(ii) "Control"-- the power to elect a majority of the board of directors of an institution or corporation.

(iii) "Institution"-- a bank, bank and trust company, trust company, national bank or *stock savings bank* located in Pennsylvania.

* * *

(v) "Proposal to acquire"-- any offer or attempt to buy or solicitation of an offer to sell or other attempt or *offer to acquire* by any means, directly or indirectly, through an intermediary or otherwise.

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7 P.S. § 112(a) (emphasis added). A “person” is defined in Section 102(s) of the Banking Code as “an individual, partnership, association or corporation.” 7 P.S. § 102(s). Based upon the plain language of these provisions, the Department has consistently interpreted Section 112(b) of the Banking Code as requiring the prior approval of the Department for any proposal to acquire voting rights of shares, including the solicitation of revocable proxies.

As a Pennsylvania state-chartered stock savings bank, the Bank is an “institution” as defined by Section 112(a)(iii) of the Banking Code, and therefore any proposal to acquire shares of the BHC which is made to 10% or more of the BHC’s shareholders requires the prior written approval of the Department pursuant to Section 112(b) of the Banking Code, because the BHC “controls” the Bank as contemplated by Section 112(a)(ii) of the Banking Code. Thus, the issue in this matter is whether the proxy solicitation sent by the Acquirer to the shareholders of the BHC for purposes of the Annual Meeting was an “offer to acquire” the “voting rights of shares” within the meaning of Section 112(a)(v) and (i) of the Banking Code, respectively, thus qualifying the proxy solicitation as a “proposal to acquire shares” within the meaning of Section 112(b) of the Banking Code.

The Banking Code does not define the term “voting rights.” However, Section 1212(a) of the Banking Code provides that:

[e]xcept as otherwise provided in the articles or in this act, every shareholder of record shall have the right at every shareholders’ meeting to one vote for each share standing in his name on the books of the institution. A shareholder may vote in person or by proxy and shall not sell his vote or execute a proxy for any sum of money or anything of value.

7 P.S. § 1212(a). Thus, the term “voting rights” as used in the Banking Code can be simply defined as the ability of shareholders to exercise their right to vote as provided in Section 1212(a) of the Banking Code. While Section 1212(a) of the Banking Code does not specifically apply to the rights of shareholders of the BHC because the BHC is incorporated under the Business Corporation Law of 1988 (the “BCL”) and not the Banking Code, the rule established in Section 1212(a) of the Banking Code is similar to that of the rule established under the BCL. *See* 15 Pa.C.S. §§ 1758, 1759. Therefore, it can be said that in any instance where shareholders are entitled to vote their shares for purposes of the business of a corporation, the shareholders have “voting rights.”

In this case, the plain language of the revocable proxy form issued by the Acquirer solicits voting rights of the shareholders of the BHC within the meaning of Section 112(a)(v) and (i) of the Banking Code, because in two instances, the proxy presents the possibility that the Acquirer would vote in his discretion, thus exercising the voting rights for the shares for which the proxy was solicited. The Department recognizes that the Acquirer may not have actually used his discretion to vote any of the solicited proxies at the Annual Meeting as was potentially possible. However, the plain language of Section 112 of the Banking Code and the proxy form used by the

Acquirer cannot be ignored.¹ Obviously, in enacting Section 112 of the Banking Code, the Pennsylvania General Assembly intended to give institutions subject to the Banking Code and the corporations that control them a greater level of protection from shareholder activity than that of corporations subject only to the BCL. This intent clearly extends to the solicitation of voting rights of such institutions' shares by proxy as evidenced by the plain language of Section 112(a)(i) of the Banking Code.² Furthermore, the General Assembly's intent is reinforced by the severe criminal and civil penalties enacted by the General Assembly for violations of Section 112 of the Banking Code contained in Section 2105 of the Banking Code, 7 P.S. § 2105. Thus, confronted with the plain language of Section 112 of the Banking Code and the proxy form used by the Acquirer, the Department is compelled to follow the statutory mandate of the General Assembly and find that the proxy form employed by the Acquirer solicited the voting rights of the shareholders of the BHC within the meaning of Section 112(a)(i) of the Banking Code.

Therefore, since the Acquirer directly or indirectly controls the Group, and had mailed a revocable proxy solicitation to more than 10% of the shareholders of the BHC seeking voting rights in at least two instances, the Acquirer was required to obtain the prior written approval of the Department in order to solicit the revocable proxies from the shareholders of the BHC used for purposes of the Annual Meeting because such solicitation constituted a "proposal to acquire shares" of the BHC within the meaning of Section 112(b) of the Banking Code.

Additionally, you have raised the issue of whether the BHC's directors were required to receive the prior written approval of the Department pursuant to Section 112 of the Banking Code in

¹ The Statutory Construction Act provides that "[t]he object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly. Every statute shall be construed, if possible, to give effect to all its provisions . . . [w]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa.C.S. § 1921(a). Here, the statute is clear- a proposal to acquire voting rights of shares requires the prior approval of the Department pursuant to Section 112(b) of the Banking Code. While it could be argued that the term "voting rights" is not clear under Section 112 of the Banking Code because it is not defined, the term is used throughout the Banking Code to denote the rights granted by Section 1212(a) of the Banking Code, which leaves little doubt as to the meaning of the term when used in the context of Section 112 of the Banking Code. *See, e.g.*, 7 P.S. §§ 1202; 1206; 1211 (comments); 1214 (comments); 1215 (comments); 1503; 1702 (comments).

² The Department notes your argument that voting rights have not been triggered by the Acquirer's solicitation of revocable proxies based upon regulations and interpretations issued by the SEC under the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78a *et seq.* However, the Acquirer's compliance with SEC regulations and interpretations is not at issue in this letter; rather, the issue is whether the Acquirer has complied with the requirements of Section 112 of the Banking Code, a statutory scheme separate and apart from the framework of federal securities laws. The Department is not aware of any court decision that has held that Section 112 of the Banking Code is preempted by federal securities laws. Thus, regardless of what federal securities laws or the SEC may say about proxy solicitation and the acquisition of voting rights, a person soliciting proxies from shareholders of an institution subject to the Banking Code or a corporation that controls such institution must first contend with the requirements of Section 112 of the Banking Code. This is an important point in light of the fact that not all institutions under the Banking Code are subject to the 1934 Act. Surely the General Assembly would have created an exception to the coverage of Section 112 of the Banking Code had the General Assembly intended that entities subject to the 1934 Act were not to be covered by Section 112 of the Banking Code.

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order to solicit revocable proxies for purposes of the Annual Meeting. Section 112(i) of the Banking Code provides in pertinent part that:

[n]o approval under this section shall be required for an acquisition or proposal to acquire shares in the case of either:

(i) an acquisition or *proposal to acquire shares by the issuer thereof* or by a person who at the time controls the institution or corporation whose shares are proposed to be acquired;

7 P.S. § 112(i) (emphasis added). It has historically been the position of the Department that the directors of an issuer of shares that controls an institution may solicit proxies from its shareholders without obtaining the prior approval of the Department under Section 112(b) of the Banking Code because such directors are engaged in a “proposal to acquire shares by the issuer” as contemplated by Section 112(i) of the Banking Code. This position is consistent with, and based upon, the duty of directors to manage the business and affairs of a bank or business corporation. *See* 7 P.S. § 1402(a); 15 Pa.C.S. § 1721. Thus, in this case, the directors of the BHC were permitted to solicit proxies from the shareholders of the BHC without obtaining the prior approval of the Department pursuant to Section 112(b) of the Banking Code because they were engaged in a “proposal to acquire shares by the issuer” as contemplated by Section 112(i) of the Banking Code.

Conclusion

For the reasons set forth above, the Department maintains its position that the Acquirer was required to receive the prior written approval of the Department pursuant to Section 112 of the Banking Code in order to solicit the revocable proxies used for purposes of withholding votes for two directors of the BHC at the Annual Meeting, because such solicitation constituted a “proposal to acquire shares” of the BHC within the meaning of Section 112(b) of the Banking Code. As such, the Acquirer is potentially subject to the criminal and civil penalty provisions of Section 2105 of the Banking Code for his failure to seek the required prior written approval of the Department pursuant to Section 112 of the Banking Code.

The Department’s analysis is based upon the facts as stated in this letter. Any change in the facts could result in an amendment or reversal of the Department’s position. This letter has been authorized by the appropriate Department personnel and constitutes a duly authorized statement of the Department’s position regarding the issues discussed herein. This letter may not be relied upon or construed as constituting legal advice.

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Please do not hesitate to contact me if you have any further questions regarding this matter.

Sincerely,

Carter D. Frantz
Acting Chief Counsel