



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 7, 2005

Conditional Approval #683
May 2005

C. Bradford Harris, Esq.
Frost, Brown, & Todd, LLC
Lexington Financial Center
250 West Main Street
S. 2700
Lexington, Kentucky 40507-1749

Re: Application for Reverse Stock Split by
First National Bank of Mayfield, Mayfield, Kentucky
OCC CAIS Control Number: 2005-SO-12-0020

Dear Mr. Harris:

This responds to the application by First National Bank of Mayfield, Mayfield, Kentucky (the “Bank”) under 12 C.F.R. § 5.46 to elect the corporate governance provisions of Kentucky law and complete a reverse stock split in accordance with those provisions. Based on the representations and commitments made by the Bank, the application is hereby approved, subject to the conditions set forth below.

I. Background

A. Facts

The Bank is amending its bylaws to elect the corporate governance provisions of Kentucky law to engage in a reverse stock split (the “Reverse Stock Split”) as permitted by Kentucky law. The Bank proposes the Reverse Stock Split to provide minority stockholders with a return on their investments by allowing them to liquidate their shares for cash at a fair value and to permit the Bank to decrease its administrative expenses incurred in servicing many stockholders who own relatively small numbers of shares, including corporate expenses associated with stockholder communications and meetings.

The Bank currently has 40,000 shares of common stock issued and outstanding, of which Jackson Financial Corporation owns approximately 39,516 shares, or 98.79%. On December 15, 2004, the Bank’s board of directors (i) approved an amendment to its bylaws to elect to be

governed by the corporate governance procedures of the Kentucky Business Corporation Act (“KBCA”) in accordance with 12 C.F.R. § 7.2000(b), and (ii) approved a proposal to amend the Bank’s articles of association, which would combine its 40,000 shares of common stock, par value \$75 per share, that are currently issued and outstanding, into 200 shares of common stock, par value \$100 per share, in a 1-for-200 Reverse Stock Split.

In accordance with 12 C.F.R. § 5.67, each shareholder other than Jackson Financial Corporation, who would otherwise hold a fractional share of the common stock as a result of the Reverse Stock Split, will instead be entitled to receive a cash payment equal to the shareholder’s fractional interest in the common stock after the Reverse Stock Split, multiplied by \$75,000, which amount is equal to the value per share of common stock before the Reverse Stock Split (\$375 per share) multiplied by 200 to reflect the Reverse Stock Split. The Bank obtained an independent valuation of the fair value per share of common stock from Southard Financial, Memphis, Tennessee. Southard Financial opined that the fair value per share of the common stock was \$341. Upon consummation of the Reverse Stock Split, Jackson Financial Corporation will own 100% of the common stock. The proposed Reverse Stock Split is subject to shareholder approval, which is anticipated to occur within 30 days of the OCC’s approval.

As a result of the Reverse Stock Split and pay out to holders of fractional shares, capital levels will decline by \$181,000. Specifically, after cashing out the fractional shares, the Bank’s capital stock account will decline to \$20,000, and the capital surplus account will correspondingly increase by \$2,980,000. Consequently, the Bank’s total capital will remain in the “well-capitalized” category.

B. Corporate Governance

National banks may adopt corporate governance procedures that comply with applicable federal banking law and safe and sound banking practices. OCC regulations provide that:

To the extent not inconsistent with applicable Federal banking statutes or regulations, or bank safety and soundness, a national bank may elect to follow the corporate governance procedures of the law of the state in which the main office of the bank is located, the law of the state in which the holding company of the bank is incorporated, the Delaware General Corporation Law, Del. Code Ann. tit. 8 (1991, as amended 1994, and as amended thereafter), or the Model Business Corporation Act (1984, as amended 1994, and as amended thereafter). A national bank shall designate in its bylaws the body of law selected for its corporate governance procedures.¹

The OCC has promulgated 12 C.F.R. § 7.2023 that codifies its decisions permitting reverse stock

¹ 12 C.F.R. § 7.2000(b).

splits. The OCC confirms in the regulation the authority of national banks to conduct reverse stock splits where "the transaction serves a legitimate corporate purpose and provides adequate dissenting shareholders' rights."² The regulation specifically recognizes that reducing costs associated with shareholder communications is an example of a legitimate corporate purpose supporting a reverse stock split.³

Counsel for the Bank represents that the KBCA authorizes Kentucky corporations to effect reverse stock splits. KRS § 271B.13-020(1)(d)4 of the KBCA grants a shareholder a right to dissent from and to obtain payment of the fair value of the shareholder's shares if the company amends its articles to reduce the number of shares owned by the shareholder to a fraction of a share if the fractional share so created is to be acquired for cash under KRS § 271B.6-04. KRS § 271B.6-04(1)(a) permits a corporation to pay money for the value of fractions of a share.

The KBCA's dissenters' rights provisions (KRS § 271B Subtitle 13) contain the following elements that are required by OCC Advisory Letter No. 2002-6:

1. Advance notice of dissenters' rights to shareholders before the shareholder meeting;
2. An independent third-party appraisal of the shares if the bank and any dissenting shareholders are unable to agree on the value of the dissenting shares; and
3. Payment by the bank of the cost of appraising dissenting shares.

The Bank has provided a certification by the Bank's president that the KBCA corporate governance procedures include the OCC required elements described above and that the Bank will agree to be subject to binding arbitration by an independent third party, to be paid for by the Bank, if the court that would ordinarily hear a dissenters' rights appraisal action under the KBCA refuses jurisdiction to appraise the shares of the Bank. The certification also includes a statement that the Bank will comply with 12 U.S.C. § 52, 12 U.S.C. § 59, and 12 C.F.R. § 5.67.

II. Discussion

The Bank may adopt Kentucky corporate governance procedures to the extent that those procedures are not inconsistent with applicable Federal banking statutes or regulations. OCC regulations expressly permit a national bank to elect the corporate governance procedures of the law of the state in which the main office of the bank is located (here the State of Kentucky).⁴

The Bank represents that reverse stock split transactions are permitted under Kentucky law, and are consistent with applicable Federal banking statutes or regulations. No provision of Federal law expressly prohibits reverse stock splits. Several provisions of the National Bank Act authorize the elements of a reverse stock split and, when read together, allow a national bank to engage in a reverse stock split for a legitimate corporate purpose if the bank provides adequate

² 12 C.F.R. § 7.2023(a).

³ 12 C.F.R. § 7.2023(b)(2).

⁴ See 12 C.F.R. § 7.2000(b).

dissenting shareholder rights.⁵ Based on these authorities, the OCC has promulgated a regulation expressly permitting reverse stock splits if the transaction serves a legitimate corporate purpose and provides adequate dissenting shareholders' rights.⁶

The Bank will increase the par value of the Bank's shares to comply with 12 U.S.C. § 52 by amending its articles of association. Banks may amend their articles of association by the vote of the holders of a majority of the voting shares of stock to determine the number and par value of bank shares.⁷ The National Bank Act permits a national bank to reduce its capital upon the vote of shareholders holding two-thirds of its capital stock and OCC approval.⁸

The Bank next proposes to replace each of the outstanding shares of common stock with new common stock at the rate of one share of new common stock for each 200 shares of common stock outstanding. The Bank will pay cash for the fractional shares outstanding. National banks have express authority to pay the cash equivalent of fractional shares of stock.⁹ The cash equivalent must be based on the market value of the stock or, if no market exists, a reliable and disinterested determination as to the fair market value of the stock.¹⁰

Judicial authority provides support for concluding that reverse stock splits for legitimate corporate purposes are consistent with the National Bank Act, where banks provide appropriate dissenters' rights. While the only Federal Court of Appeals case to address reverse stock splits directly, *Bloomington Nat'l Bank v. Telfer*, decided on the facts that the transaction before it violated the National Bank Act, the court declined to determine if reverse stock splits would be permissible for valid business purposes if dissenting shareholders' rights were provided.¹¹ The court also noted that the decision was limited to the facts of the case.¹²

In *NoDak Bancorporation v. Clarke*, the Eighth Circuit held that national banks could effect freeze-out mergers to allow a holding company to obtain 100 percent ownership so long as the national bank has a valid corporate purpose and observes dissenters' rights.¹³ The *NoDak* court

⁵ See OCC Advisory Letter No. 2002-6 (July 17, 2002)(Reverse Stock Split Procedures); Conditional Approval 434 (Dec. 15, 2000); Interpretive Letter No. 786 (June 9, 1997); and Interpretive Letter No. 275 (Oct. 21, 1983).

⁶ See 12 C.F.R. § 7.2023.

⁷ See 12 U.S.C. § 21a; see also 12 U.S.C. § 52 (par value may not exceed \$100 per share).

⁸ See 12 U.S.C. § 59.

⁹ See 12 C.F.R. § 5.67(c).

¹⁰ "The cash equivalent is based on the market value of the stock, if there is an established and active market in the national bank's stock." *Id.* In the absence of an established and active market in the Bank's stock, the Bank obtained an independent valuation as to the fair market value of its shares.

¹¹ *Bloomington Nat'l Bank v. Telfer*, 916 F.2d 1305 (7th Cir. 1990) ("*Bloomington*").

¹² See *id.*, 916 F.2d at 1308 n.4,1309.

¹³ *NoDak Bancorporation v. Clarke*, 998 F.2d 1416 (8th Cir. 1993) ("*NoDak*").

found that a national bank may engage in any merger not inconsistent with 12 U.S.C. §§ 214a and 215-215a, and that freeze-out mergers are consistent with those sections.¹⁴ More recently, a district court in the Tenth Circuit relied on *NoDak* to hold that a bank may effect a freeze-out merger to consolidate with another bank and become a wholly-owned subsidiary of an existing bank holding company.¹⁵

In *Lewis v. Clark[e]*, the Eleventh Circuit determined that a national bank may not offer different consideration to shareholders when the bank effects a freeze-out merger under 12 U.S.C. § 215a.¹⁶ The court held that the OCC lacked authority to approve mergers where minority shareholders receive cash for their shares and majority shareholders receive stock in the resulting bank, even in cases where the minority shareholders have appraisal rights. That case did not involve a decision, like the present case, where a regulation expressly permits reverse stock splits. Since the OCC has adopted section 7.2023 following a notice and comment procedure, courts reviewing an OCC decision approving a reverse stock split should give deference to the OCC's reasonable interpretation of a statute that it administers.¹⁷ Moreover, the OCC has permitted national banks to conduct reverse stock splits in numerous situations since *Lewis* and *Bloomington* were decided. In the period since *Lewis* and *Bloomington*, the OCC has approved reverse stock splits for banks located in fourteen states in cases where the banks had legitimate corporate purposes in conducting the transactions.¹⁸ Thus, applicable statutory and regulatory provisions and the weight of judicial precedent would permit reverse stock splits for legitimate business purposes, provided dissenters' rights are available.

The Bank has articulated legitimate business purposes in effecting a reverse stock split. The Bank indicates it wants to decrease the administrative expenses incurred in servicing many stockholders who own relatively small numbers of shares, including corporate expenses associated with stockholder communications and meetings. Eliminating burdens associated with a shareholder constituency is a proper business purpose.¹⁹ It also is a valid business purpose to effect a merger in order to reduce corporate expenses associated with shareholder communications and meetings.²⁰ The OCC expressly recognizes these corporate purposes in its regulation permitting national banks to conduct reverse stock splits.²¹ To avoid undermining the shareholder protections of 12 U.S.C. §§ 214a and 215-215a, however,

¹⁴ See *id.*, 998 F.2d at 1419-20 and 1425.

¹⁵ See *Moody v. First National Bank, Sallisaw*, CY-00-306-5 (E.D.Ok. July 5, 2001).

¹⁶ *Lewis v. Clark[e]*, 911 F.2d 1558 (11th Cir. 1990), *reh 'g denied*, 972 F.2d 1351 (1991) ("*Lewis*").

¹⁷ *NationsBank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995); *United States v. Mead Corp.*, 533 U.S. 218, 231 n.13 (2001).

¹⁸ See Advisory Letter 2002-6, *supra*; Conditional Approval 541 (July 30, 2002).

¹⁹ See *Leader v. Hycor, Inc.*, 479 N.E.2d 173, 178 (Mass. 1985); see also *Nash v. Farmers New World Life*, 1976 U.S. Dist. 15,846, *48 (S.D. Ohio, 1976).

²⁰ See *Teschner v. Chicago Title & Trust Co.*, 322 N.E.2d 54, 58 (Ill. 1974).

²¹ 12 C.F.R. § 7.2023(b).

a reverse stock split must provide shareholders adequate dissenters' rights to ensure that they receive a fair price for their shares. Those dissenters' rights need not be identical to those located in sections 214a, 215, and 215a. Accordingly, the Bank may effect a reverse stock split as long as it has a valid corporate purpose for the transaction and observes appropriate dissenters' rights.

AL 2002-6 does not specify all aspects of dissenters' rights that a bank must offer to dissenting stockholders in connection with a reverse stock split. For example, AL 2002-6 states that a bank must provide "[a]n independent third-party appraisal of the shares if the bank and any dissenting shareholders are unable to agree on the value of the dissenting shares." However, AL 2002-6 does not state whether the independent third-party appraisal is to be made by one appraiser or by a committee of appraisers. As such, to the extent that specific aspects of dissenters' rights are not covered by the guidelines set forth in AL 2002-6, the Bank proposes to follow the procedures set forth in 12 U.S.C. § 215a. In effect, the Bank will supplement the dissenters' rights outlined in AL 2002-6 with certain aspects of the dissenters' rights set forth in 12 U.S.C. § 215a, provided that any such additional rights afforded by section 215a do not conflict with the rights set forth in AL 2002-6.

Consequently, minority shareholders in the reverse stock split will receive dissenters' rights comparable to those under the National Bank Consolidation and Merger Act (the "NBCMA").²² Specifically, the Bank has represented that it will provide notice of dissenters' rights to the minority interest holders before the shareholder meeting acting on the reverse stock split proposal; pay the cost of an independent third party appraisal of the shares if the Bank and any dissenting shareholders are unable to agree on the value of the dissenting shares; and pay the cost of a binding arbitration by an independent third party, if the court that would ordinarily hear an appraisal action under the corporate governance procedures refuses jurisdiction to appraise the shares of a national bank. The Bank will not pay the costs of attorneys' fees incurred by and costs of experts retained by dissenting shareholders for any such proceeding.

III. Conclusion

For the above reasons, including the representations and commitments made by the Bank, we find that the reverse stock split application is legally authorized and meets the other statutory criteria for approval. Accordingly, this application is hereby approved, subject to the following conditions:

1. The Bank will elect the corporate governance provisions of Kentucky law.
2. The Bank will provide for dissenters' rights comparable to those found in 12 U.S.C. §§ 214a, 215, and 215a.

²² Under the NBCMA, a dissenting shareholder must either vote against the merger, or give written notice of dissent prior to or at the shareholder meeting at which the shareholders vote on the merger. The value of the dissenting shareholders' shares is determined by an appraisal made by a committee of three persons: one chosen by the dissenting shareholders, one chosen by the directors of the bank (as it exists after the merger), and one chosen by the other two members of the committee. If the committee fails to determine a value of the shares, or a dissenting shareholder is not satisfied with the value determined, the OCC must make an appraisal of the shares. See 12 U.S.C. §§ 214a(b), 215(b)-(d), and 215a(b)-(d).

3. If any shareholders dissent from the reverse stock split, the Bank will pay the cost of any appraisal that may occur, but not the costs of attorneys' fees incurred by and costs of experts retained by dissenting shareholders.
4. If the appropriate court(s) decline to accept jurisdiction of an appraisal action, the Bank will pay for binding arbitration by an independent third party to appraise the stock but not the costs of attorneys' fees incurred by and costs of experts retained by dissenting shareholders.

Please be advised that the above conditions of this approval shall be deemed to be conditions "imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818(b)(1).

Please notify the OCC when the change in capital has been completed in accordance with this approval. The notification should state the date of the change, and the dollar amount of the reduction in the common stock and surplus account associated with the payment for fractional shares. The notification should include a certification that shareholders approved the change in capital structure according to law, regulations, and the Bank's Articles of Association. A secretary's certificate of shareholder approval and a certified copy of the amendment to the Articles of Association should be included. The notification also should include a statement that the change in the capital structure complies with all applicable laws and regulations. Upon receipt of the notification, the OCC will review the reduction in capital attributable to the payment for fractional shares.

If the reverse stock split is not consummated within one year from the approval date, the approval shall automatically terminate unless the OCC grants an extension of the time period. Please advise Brenda E. McNeese, Senior Licensing Analyst, within 10 days of the effective date of the reverse stock split.

Please include CAIS Control Number 2005-SO-12-0020 on all correspondence related to this application.

This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable laws and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

If you have any questions, please contact Brenda E. McNeese, Senior Licensing Analyst, at 214-720-5711, ext 5711.

Sincerely,

signed

Stephen A. Lybarger
Director for Licensing Activities