
GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Florida, Tennessee, Wisconsin, Minnesota, and Iowa!

CONSULTING AGREEMENTS

As most *Musings* readers know, we heavily push establishing appropriate board and management succession with our community bank client base across the country. As a practical matter, many of our community bank clients have senior management in the bank all “bunched up” in their sixties. Unfortunately, several of our banks with senior management retiring do not have new management scheduled to come in, or anyone in the existing middle management group moving up. This can create a very difficult situation for a community bank. As a result, often our community bank clients put retiring senior managers under Consulting Agreements for some period of time to help transition to new management, to provide direction, to consult on historical practices, and the like. There is no problem with this approach. In fact, in many cases it is a necessary one. If a retiring executive officer is going to become a consultant with the bank, it is imperative that that officer have a contract that fully explains the retiring officer’s/consultant’s duties and responsibilities and the bank’s duties and responsibilities – not to mention compensation issues. It also needs to be determined whether the services will be provided to the bank directly and paid for by the bank, or provided to the holding company and paid for by the holding company. That should also be spelled out clearly in the written Consulting Agreement. If anybody needs assistance on this, we would be glad to help you.

THE VALUE OF PERSONAL RELATIONSHIPS

We recently read what we consider to be an interesting article in the *American Banker* newspaper. This article focused on the value of personal relationships. The article was comparing technology companies that have no personal relationships with their users and banks that have a personal connection with their customers. The article cautioned that a bank's personal relationship with its customers is one of value, and banks should be careful not to give that value away to big data companies in looking to partner with them or utilize their products and services.

The value of personal relationships in business, and particularly in community banking, is certainly not a novel concept. It has served as the foundation of community banking for decades, and we believe it will continue to do so. We have said previously in a number of *Musings* that even though technology is changing the way we operate, technology will supplement, not supplant, personal relationships. In other words, the community banks that will thrive in the future are those that appropriately mesh personal and digital customer interactions. We do not anticipate that one will completely rule to the detriment of the other.

Please let us know if you would like to receive a copy of the article. We are happy to provide it.

TRANSACTION CONTINGENCIES

Over the past couple months, we have been assisting a community bank client in the consideration and pursuit of a potential acquisition transaction. This particular opportunity followed what is somewhat of a "normal bidding procedure," where the seller solicited preliminary indications of interest, received those indications of interest, selected banks to complete due diligence, and then, following due diligence, asked for final indications based on due diligence.

With our client, we followed this process to a T. We recently submitted, based on due diligence, the final indication of interest that included all the terms and conditions of the proposed transaction, including the transaction contingencies and conditions to closing. Some of these are pretty standard, such as representations and warranties being true, no material adverse effects prior to closing, and the like. However, some were more specific to this transaction, such as the execution of required employment agreements, treatment of certain litigation, and the like. What is a little bit interesting is that in this particular situation the seller's advisors came back and asked us to remove these deal specific contingencies. Our response was "no."

We certainly do not begrudge the seller's advisors for asking for the removal of the contingencies in an effort to try and get as good a deal as possible for their client. Similarly, we expect that the seller's advisors do not begrudge us for incorporating certain requirements into the transaction. As can be expected with any deal, there are some areas where you ought to be willing to give, and there are other areas where you should not. Good acquirers understand the difference between these two and are willing to give where appropriate but hold the line where necessary. We think our client certainly did so in this situation.

SPEAKING OF NEGOTIATIONS...

The past five or so years have provided our firm numerous opportunities engage in the negotiations of a bank merger transaction. We have done dozens of deals on each of the buy and sell side. Based on our experience, we are convinced that there really are three separate stages of negotiation in a bank acquisition transaction.

The first stage of negotiation is that of the indication of interest. This is the preliminary document that sets forth the material terms relative to the transaction. It essentially represents a meeting of the minds of the parties involved.

The second stage of negotiation in an acquisition transaction is that of the definitive merger agreement. This is the "big contract" that incorporates all of the terms and conditions of an acquisition transaction. These contracts are 30 pages on the short side and sometimes in excess of 100 pages. Due to their sheer volume, this is the bulk of the negotiation in a transaction.

The third phase of contract negotiation is after the execution of the definitive merger agreement and prior to closing. This is essentially the negotiation of items that pop up between the date of signing the agreement and the date of closing.

As a buyer or seller, it is important to keep these three stages of negotiation in mind. It is particularly important when buyers or sellers have completed the first two phases of negotiation and have a binding agreement but have not yet closed the deal. Almost every deal inevitably gets to a point where it feels like it is "in the ditch" and falling apart. This is where the third stage of negotiations takes place so you can figure out a way to get it out of the ditch and across the finish line.

SHARE REPURCHASE TRANSACTIONS

During a recent discussion with a number of community bank directors, an interesting issue relative to share repurchase transactions was raised. The question is essentially when is it appropriate for a bank holding company to engage in a share repurchase transaction when the holding company's

shareholders' demand for liquidity exceeds the holding company's ability to satisfy that demand. In other words, if there are a number of holding company shareholders that desire liquidity and the holding company is not able to satisfy all of that demand, should the holding company repurchase any shares at all or should the holding company simply say no to everyone until it is at a point where it can say yes to everyone?

Our response is that an answer that is an outright "no" to everyone is not the best answer. We have said numerous times previously that one important aspect of enhancing shareholder value is providing liquidity, which is the ability of the shareholder to convert their shares to cash at a fair price in a timely manner. If a board is presented with liquidity demands that exceed its ability to fulfill those demands, we think the board needs to prioritize those demands. Certainly, the board should not engage in choosing favorites, but in the exercise of its fiduciary duties it should look to provide what liquidity it can in an appropriate order of repurchase priority.

We are working with this group of community bank holding company directors to figure out how exactly their share repurchase policies and priorities are going to work. We believe we will end up with what is essentially a share repurchase policy that outlines the various considerations the board will give in establishing share repurchase priority when there are circumstances that do not allow for the holding company to fully satisfy all liquidity demands. We think this is a better end result than is essentially a ban on share repurchases until all liquidity demands can be satisfied.

NEW ESOP/KSOP REGULATIONS

Many *Musings* readers have Employee Stock Ownership Plans (ESOPs) or 401(k) employee stock ownership plans (KSOPs). As most of you know, these particular entities are super employee benefits but are also complex and governed by various rules and regulations. The IRS recently finalized a rule on hardship distributions from ESOPs and KSOPs. Some of the new hardship provisions are required and some are optional. Please note also that Congress has passed extensive provisions that are designed to improve qualified retirement plans, including ESOPs and KSOPs, which include a provision increasing the age for the Required Minimum Distributions (RMDs) from 70 ½ to 72.

To comply with the rules, your ESOP or KSOP will need to be amended. Please let us know if we can assist. Also, if you would like to a memorandum on the changes in the rules, please let us know and we will forward it on.

PRACTICE WHAT WE PREACH

Our firm has always prided itself on practicing what we preach, from succession planning to strategic planning. Strategic planning for our consulting and law firms really involves the same issues as it does for a community bank (i.e., the identification of the firm's position in the marketplace and the direction in which we are going to head in the next few years). Strategic planning for a personal services business also involves allocation of financial and human resources. In other words, where is the best place to spend your time? Is it generating or producing business?

Our recent meeting was very enlightening. It will result in maintaining the core of our firms, which is community bank based, founded on exceptional service to the client, as well as moving in the same direction as the industry is moving, with a heavy emphasis on technology.

CONCLUSION

Welcome to 2020! We look forward to seeing many of you this week at the Chairman's Forum in Naples and many of you at the various national community bank conferences coming up in February and March.

We hope everyone had a wonderful New Year's and a good start to 2020. See you in two weeks.

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