The
Chairman's Forum
Newsletter
Opening the door to new ideas
Gerrish Smith Tuck, Consultants and Attorneys
April 2018

As we are moving through Spring, it seems that things are heating up for many community banks on the business side (even though many of you are still trying to shake lingering Winter conditions). That includes an active M&A market, setting up strategic planning sessions, dealing with stockholder issues for annual meetings and a host of other areas. As a result, we have been involved in a number of different situations across the country which range from unusual to hostile and in almost all of these it brought to light some key aspect of the role the Chairman of the Board should play or how the Board of Directors and senior management should conduct themselves. Therefore, we wanted to pass these concepts and ideas along to raise some thoughts in your mind about the roles played by you, your Board, your management and your organization in general.

In addition, you will see that we also are highlighting some upcoming conferences and presentations where we will be. We are firm believers that you can never have too much education and, accordingly, we would ask you to take a look at these conferences and presentations, and we would encourage you or your Board and management to "come see us in person" as we would love to have the opportunity to meet you, share ideas or catch up with old friends.

Please let us know how we can continue to help.

Happy Reading!



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Chairman's Summary

- Chairmen must know who they represent.
- Management should be part of the Board.
- Check your corporate documents … closely.
- A bad deal is not better than no deal at all.
- Upcoming M&A conference announced.

Who Does The Chairman Represent?

Have you ever asked yourself the question of who you truly represent in your role as Chairman of the Board? Is your job really just ministerial and administrative where you "get" to gavel the meeting to order, but otherwise you are only there for your own personal interests? Or, rather, since most Chairmen are also stockholders (often very large stockholders), is the true role of the Chairman to be an advocate on behalf of the stockholders to the Board of Directors for stockholder concerns? Maybe, as a large stockholder, you feel that your primary obligation as Chairman is to protect your interests and those of your family (particularly in family-owned organizations) to make sure the rest of the Board and the management team are not losing your investment.

Maybe you view yourself as the primary representative of the entire Board of Directors (or perhaps just the outside directors) to ensure that the fiduciary duties of directors are being exercised to make sure management is staying in line, doing what they are told and producing good financial results. It clearly seems confusing that the Chairman might have a role in all of these circumstances. But, in fact, we would suggest that the following roles for the Chairman each might apply in different circumstances:

1. A liaison between the Board and all stockholders.
2. An advocate to the Board and the management group on behalf of large or primary stockholders.
3. The Board peacemaker between rival factions of the Board.
4. The defender of management against other Board members or stockholders when management is wrongfully under attack.
5. The chief strategic officer for the organization setting strategic plans and directions.
6. Playing the role of "Honest Abe" to tell directors when they are out of line, to tell stockholders when their concerns are not well founded, to discipline Board members, to deliver bad news or to terminate management.

There are probably hundreds of other scenarios we could come up with, but understand the role of the Chairman is multifaceted and different circumstances will call for different roles. One minute you may find yourself defending management and the next minute find yourself siding with stockholders on a key issue. Be prepared for a dynamic role and

remember “The Chairman is always right!”. (We added that just to ensure you would circulate this to other Board members.)

Should Management Serve on the Board?

Some of you reading this question are answering quickly with, “Of course management should be part of the Board of Directors”. But we are beginning to encounter circumstances where not everyone feels that way. Would it be possible, for example, to have a bank holding company Board with no management representatives on it, but only outside directors even though management serves on the Board at the bank level? The answer is that it certainly is possible, although it is probably not very smart.

The role of Board members, as we all know, certainly involves the exercise of fiduciary duties and obligations. Part of those key fiduciary duties is the duty to be informed. In legal terms, we call that the “duty of care”. So consider whether a Board of Directors can fulfill its duty of care to be appropriately informed and to have all the information needed to make valid Board decisions for the governance of a financial institution without receiving input from senior members of bank management. Consider, for example, a circumstance where the holding company Board believes strategically that profitability needs to be improved and, as a result, unprofitable branch locations should be closed. They then direct management to do so. Do these outside Board members who are not bankers truly know whether this will cause regulatory criticism from a Community Reinvestment Act standpoint? Is the Board aware of the employee issues at the bank level where the closure will impact them and have they fully considered those ramifications?

In essence, you can see the potential problems which are that the Board, without having management representation at the holding company level, could easily be engaged in making strategic decisions without all the necessary information that a management representative could provide and arguably that could result in a breach of fiduciary duties. Therefore, as Chairmen, having appropriate representation of senior management at both the bank level (which is often required statutorily or by regulation) as well as at the holding company level, is simply good business sense as well as a potential fiduciary necessity.

Check Your Corporate Documents … Closely

In past editions of *The Chairman's Forum Newsletter*, we have raised the issue of being sure as Chairmen and as Board members you know what is truly in your Articles and Bylaws of the holding company as well as the Articles and Bylaws of the bank. We have somewhat jokingly suggested that if you cannot put your hands on a copy of those documents within about five minutes, or if your management team can't, that they certainly have not been reviewed in a while and are in need of an update.

Those documents can be your best friend or your worst enemy depending on how the various provisions are used or twisted to a particular party's interest. However, the provisions within those documents rarely become a problem for a financial institution until they actually become a problem, but then it's a big problem. Moreover, your documents may be silent on particular issues and, therefore, you do not think about it, but then state law may step in and create a circumstance you are not expecting. For example, you never think about cumulative voting in the shares of your

stock and there is no reference to it in your documents, but in a confrontational situation does state law allow for cumulative voting? Or has state law changed since the last time you updated your documents?

Or, consider also a more positive outlook on things, but where you are then restricted by your documents. For example, you need or want to raise capital for some type of positive activity like buying another bank. You have Board members or perhaps an "angel investor" who is willing to purchase a large amount of stock and the company then wants to utilize the new cash resources to make an acquisition. However, if your corporate documents provide preemptive rights to stockholders, you cannot engage in that transaction without first going through the additional time and expense of making a pro rata offer to all stockholders. So, your positive initiatives to improve overall stockholder value are actually restricted by the steps you have to take with stockholders and may make the transaction cost prohibitive.

Who has the ability to call a special meeting of stockholders of your organization? You would probably think that the Board would be the one to make that decision. That typically is the case, but your corporate documents may provide that the President, the Chairman of the Board or even as little as stockholders owning 10% of the shares (which could be one person) can call a special meeting of stockholders. Would you want that to happen? The key point is that many of us have not reviewed, evaluated and updated our corporate governance procedures, the ways we conduct our meetings and other administrative processes by modernizing our corporate documentation. Board members may want to encourage that process to take place on a periodic basis and we would suggest probably at least once every five years.

"Pull the Plug" on a Bad Deal

Sometimes, the Chairman and other Board members may be required to "pull the plug". You will be happy to know this does not mean the Chairman is responsible for the medical condition of fellow directors, but it may result in the Chairman or Board members having the difficult task of killing a potential M&A deal even if, at first blush, it looks good or even if management is supportive of the deal. Quite frankly, we are seeing a bit of an unusual approach by many potential purchasers in the current community bank M&A environment. That approach is one where the buyers are coming to the negotiating table with a bit of an attitude of "we are here to do you a favor". As a result, the buyers see no benefit in negotiating terms that make a potential seller happy (monetarily or otherwise). The buyers seem to assume that what they view as a "generous" offer should not be subject to negotiation by the Board of a potential seller and that, "if the stupid seller does not hurry up and agree to these terms we have proposed, we will take our money and go buy another bank". If that is their attitude, you may need to let them go elsewhere.

In those circumstances, we have often heard Board members indicate that they are open to doing the deal, they simply need more time to look at the possibility of the transaction, they want to get comfortable with the terms and receive some independent advice to ensure they are exercising their fiduciary duties, etc. However, the impatient buyer continues to try to force the transaction down the throat of the potential seller which winds up turning the seller off to what might be a good transaction on paper, but winds up not "feeling right" to the seller. In those circumstances, we are pretty candid

with potential sellers in advising that if your "gut" is telling you not to do the deal, you probably shouldn't do the deal. If the seller's expectations are reasonable, in line with current market pricing and other general expectations, but a buyer is just not willing to meet those reasonable expectations by a seller, then it may fall to the Board or even the Chairman to "pull the plug" on a potential deal and refocus the organization's attention back on the day to day operations. If you have positioned your organization to remain independent but simply consider opportunities when they are presented, that will be easy to do. If you have already conceded the fact that you are going to sell, then the Board may be more apt to accept what is otherwise not a positive deal for the stockholders in the long run. So, buyers should be a bit less pushy in trying to bully sellers into deals and sellers need to go into any negotiations with an open mind, but with a safety net of pulling the plug on a bad deal.

Meeting Adjourned

As we wrap up this month's edition of *The Chairman's Forum Newsletter*, we also wanted to make you aware of a merger and acquisition conference geared specifically for community banks that our firm hosts every year in conjunction with the Independent Community Bankers of America. This year's conference is going to be held June 11 and 12 at the historic St. Paul Hotel in the Minneapolis/St. Paul area. Jeff Gerrish, Philip Smith and Greyson Tuck will be handling the conference and opportunities for private consultations with any or all of them will be available as well.

In addition, we also will be hosting a Director and Executive Management Forum in conjunction with the Barret School of Banking on May 24 in Memphis, Tennessee. This is a highly focused session running from 10:00 a.m. until 3:00 p.m. and you do not have to be a member of the Barret School of Banking to attend.

We would love to see you at either or both of these conferences and if you would like more information, please visit the ICBA website, the Barret School of Banking website or contact us and we will provide you the necessary information.

Until next time,



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