The
Chairman's Forum
Newsletter
Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

July 2019

As we are now in the throes of Summer and banks and even firms like ours navigate around everyone's Summer vacations, we thought perhaps picking one or two topics and having a deep dive might not be the most exciting Summer reading. Accordingly, in this month's edition of *The Chairman's Forum Newsletter*, we are going to hit you with a number of quick topics and bullet points to be thinking about, and later in the year we may take a deeper dive into one or more of these. So, we hope each of these tidbits can provide some benefit to you and provide some insight into what is currently happening and your role as Chairman and as Directors. If you have questions or comments about any of this, we would love to hear from you. We continue to hope your Summer is unfolding well.

Happy Reading!

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Chairman's Summary

- What Kind of Chairman Do You Really Need?
- Unique Board Succession Planning
- Putting Words Into Action
- M&A Fiduciary Duties
- Tough Decisions by a Chairman
- Maintaining Your Negotiating Leverage

What Kind of Chairman Do You Really Need?

There are multiple ways an individual may become Chairman of the Board of their organization. Sometimes it is, candidly, because the individual is the oldest, owns the most stock, is viewed as the community leader, or some other circumstance. But shouldn't the real answer be that the Chairman of the Board should be the person who has the best skillset to serve in that capacity? That would likely be your take, provided that you are from an organization that also views the Chairman's position as having a true function in terms of running meetings, being a liaison to shareholders, and other factors.

Recently, we had the opportunity to visit with a client who had a bit of an unusual Chairman structure. This was a relatively large, family-owned

organization with family members serving on the Board and being legacy members of management, so you might expect there to be a family member who perhaps serves as the Chairman, President and CEO. However, for this organization, they realized that they needed an individual with a specific skillset in governance and administration to lead and run the Board. As a result, there was an outside third party who was brought in to serve in that capacity and serve on their Board. The result has been tremendously successful. It allows the family members to focus on shareholder value and other issues critical to them, and allows the Chairman to focus on her job, which she does very well. So, consider that there is not one right way to serve as Chairman or to assume the role of Chairman.

Unique Board Succession Planning

We have a client that has considered multiple ways to improve on board succession planning. The typical things come to mind such as mandatory retirement age, board evaluations, and the like. However, this organization had implemented a term limit, not tied to age but tied to the number of years of service on the Board. In essence, they picked a default maximum number of years that they thought would be appropriate for anyone to serve on the Board, such as 20 years. Therefore, they were not really focused on the age of individuals as much as they were their years of service. Perhaps an alternative for many of you to consider.

Similarly, we also had a client who implemented, not mandatory retirement and not Board evaluations, but a combination of the two. In essence, it was a mandatory evaluation process once directors reached a certain age. At that point, directors agreed to be subject to an annual review

process and, if a majority of the Board felt it would be best for the individual not to sit for reelection, then the individual would rotate off the Board. Again, keep all of your options open in considering appropriate succession planning techniques that might work for your organization.

Putting Words Into Action

Over the past few months, we have had the opportunity to receive follow-up emails and telephone calls from a number of you indicating that something in one of our newsletters prompted you to take action in a certain area or to call us and seek further advice or pursue similar strategies. We are always grateful for that. In fact, one individual gave us a reminder of the type of language you hear on a typical call-in talk show on the radio where someone might say they are a "long time listener, first time caller." This individual began the call by indicating he was a "long time reader, first time caller." We thought that was a great and humorous opening line. His comment was that he was glad he had never had to call in the past on a particular issue, but there was something raised in one of the newsletters that he wanted more insight on. If you fall into that category of being a long time reader but have never had the need or the desire to call us, we hope that is for positive reasons. But if you ever want to simply pick up the phone or drop us an email, we would love to hear from our long-time readers.

M&A Fiduciary Duties

In last month's *Chairman's Forum Newsletter*, we talked about the fiduciary obligations of board members and the Chairman relative to the current acquisition environment. In particular, we talked about when a

potential duty or obligation to take further action exists. For example, if you are merely having a cocktail conversation with someone and they say they would like to talk to your Board about doing a deal, do you really have an obligation? On the other hand, if someone sends you a formal written offer but the Board has previously said it wants to remain independent, do you have an obligation to do anything? And on top of all of those, when do you need to let stockholders know something is going on?

As a result of those issues, we indicated that we had a previous article we had dusted off that talks about board duties in the acquisition context. We indicated that people could contact us if they wanted a copy and numerous people did. As a result of that strong response, what we are electing to do is to simply provide the article, "Unsolicited Offers: From Cocktail Conversation to Firm Offers, When Does an Affirmative Director Duty Arise" attached to this newsletter. If you need more information about those particular circumstances, we would be happy to discuss it with you confidentially.

Tough Decisions by a Chairman

We are beginning to see an increasing number of tough decisions that the Chairman has to make. In particular, as you might suspect, the current M&A environment is producing some tough conversations and difficult decisions. Perhaps one of the toughest is for a Chairman of the Board and the Board of Directors to ultimately decide to sell the organization. We understand that in many cases it is not just selling the bank, but it is selling the family business, it is selling one of the last vestiges of your hometown community, and you may rightfully have concern about jobs lost and impact

on employees, the long-term viability of your community, or other factors. Therefore, you are correct not to take those decisions lightly, to make sure you fully exercise your fiduciary duties and to hire professionals who are in tune with the unique issues a community bank sale brings compared to other organizations.

Interestingly, though, are a number of situations we have run into recently where there is perhaps an even tougher decision, and that is the decision to call off a potential sale. Once the transaction begins to unfold, the buyer may not meet its obligations, there may be changed circumstances, due diligence by either party may reveal something not expected at the outset, or similar factors. In those circumstances, the Chairman still has a job to do in upholding the obligation to shareholders to ensure that any potential deal is appropriate for its Board and its stockholders. Therefore, you may also be confronted with a difficult decision of having to terminate discussions on a potential deal and look elsewhere, or retool your entire strategy. Don't assume just because a preliminary decision has been made to sell the organization that all of the heavy lifting is completed. This is why we always caution potential sellers not to spend their money before they actually have it (no condo before close). More and more deals are falling apart for a myriad of reasons and, in some circumstances, it is up to the Chairman to make the difficult decision to finally terminate a bad deal.

Maintaining Your Negotiating Leverage

In today's merger and acquisition environment, we often see selling institutions make a critical mistake which is to assume, once the decision to sell is made, that the process is really out of their hands and they are

somewhat at the discretion of whatever the buyer wants to do. Likewise, we often see Boards struggle with the incorrect idea that if they are going to sell, they believe they may have to simply auction themselves to the highest bidder regardless of who that party is.

However, we want to reemphasize that potential selling organizations still should maintain their negotiating leverage. If you are considering a possible sale, it does not automatically mean you have to go through an auction process to the highest bidder, whoever that is. There are strong fiduciary reasons why a potential seller can actually "pick your partner," provided that partner is willing to pay a reasonable value and provide other benefits to your organization. As we often say, a selling organization should not blindly just throw itself on the market, but should decide what it wants out of a transaction and should, in fact, ask for what it wants. Do you want to maintain your charter? Do you want to still have board members? Do you want the buyer to keep the name of your bank? Do certain employees need employment contracts to make the deal successful? Just because you are considering a potential sale does not mean that you have no say-so in the future transaction. Quite the contrary - to exercise appropriate fiduciary duties, the Chairman and the Board need to continue to keep control over the process, even from a seller's perspective. Certainly there can be tradeoffs between the softer "social" issues that impact a transaction and the financial value being offered by a buyer. The key is to understand when you can rely on either one for making a decision. If we can help provide guidance, please let us know.

Meeting Adjourned

As we are moving from July to August, colleges and schools will be starting back and the result is that many organizations begin thinking about their strategic planning for the second half of the year to be prepared for 2020.

If you have not already scheduled strategic planning for this Fall or early next Spring, we would encourage you to move forward with those plans. If our firm can be of assistance we would love to get something scheduled as quickly as possible, since the Fall is already filling up quickly. Let us know how we can help.

Until next time,

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Unsolicited Offers:
From Cocktail Conversation to Firm Offers
When Does an Affirmative Director Duty Arise

By Philip K. Smith
Gerrish Smith Tuck

As the merger and acquisition environment continues to percolate with many institutions jumping at acquisition opportunities and with other institutions finding themselves as targets of increasingly aggressive buyers, it seemed appropriate to dust off an article that we published during the height of the last acquisition frenzy when we began to get a lot of questions about the board's duty when receiving overtures from another organization. Questions that often come up among institutions that are frequent targets of unsolicited offers are how to respond to an unsolicited offer and when the duty to take action or notify the stockholders arises. While sometimes the answer may be obvious, there are gray areas that may leave a director wondering, am I supposed to report that to the board or was that small talk?

This updated article provides current guidance on situations that can be considered mere "cocktail conversation" and which conversations require a director to report back to the full board. The following scenarios mirror situations that typically present themselves in real life and are designed to offer some guidance in making the decision of whether reporting is necessary.

The first and most common situation is where you or one of your fellow directors has some informal discussions with a representative of another institution. During your conversation, that individual makes a comment along the lines of: "We should consider putting our two banks together". In this situation, the board member really has no obligation to do anything with that information and it is merely what it is, an informal discussion like you might have at a cocktail party, bank conference, etc. There is really not even a duty to report that conversation back to the full board, though many directors would probably do so.

A trickier situation arises when an individual board member has a more substantive discussion with another bank representative, where the other individual says something like: "Our bank is looking for new markets for growth and our board thinks your bank and your community would be a good fit for us. We would like to talk to you and your board about a possible affiliation of our institutions and, if preliminary talks go well, we will even be happy to provide your bank with a formal written offer". With that type of more substantive discussion, the director who receives that information does have an obligation to report that discussion back to the full board. However, the board really has no affirmative duty to take additional steps unless and until there is additional contact by the bank who initiated the discussion.

Another problematic situation can arise when the bank president or the chairman of the board or an individual director receives a letter from another institution that is somewhat in the nature of a general solicitation. Assume the letter says something like the following: "ABC Regional Bank Holding Company is constantly seeking growth and expansion opportunities and has identified

your institution as a likely candidate for discussions of a possible affiliation. We look forward to discussing these opportunities with you. Please call us at your earliest convenience to arrange a time when we might discuss these matters in more detail". The individual receiving that kind of general solicitation letter certainly has an obligation to bring it to the entire board of directors for the board to at least give preliminary consideration to it. However, because the letter is merely in the nature of a general solicitation that might have been sent to dozens of banks, the board really has no additional or affirmative obligation to take specific steps to contact the person sending the letter, to conduct any independent analysis and certainly has no additional obligation to report such information to the stockholders. In that situation, the board should note that it received the letter, note that the board gave preliminary discussion to it and, assuming the board has no current desire to sell the institution, the board may simply take no further action unless and until the other institution makes a more formalized offer.

On the other end of the spectrum, through preliminary discussions with bank officers or directors or simply on a totally "out of the blue" basis, your bank receives a more formalized letter that says something like the following: "ABC Bancorporation believes that an affiliation with your institution would produce mutually beneficial results for both entities. After reviewing publicly available financial information in conjunction with surveying relevant aspects of your banking market, the board of directors of ABC Bancorporation has authorized me to present to you the following offer for a proposed affiliation of our institutions. ABC Bancorporation will pay to stockholders of your bank cash equal to $300 per share representing an acquisition price of 1.50 times June 30, 2019 book value and 14.5 times estimated annualized earnings for 2019 for your institution. The offer is subject to the execution of a definitive agreement and further due diligence".

That type of letter obviously constitutes a formal written offer to your institution that requires the board to take certain specific steps. The board cannot simply consider it briefly at a board meeting, vote up or down and move on to other business. The receipt of that type of formalized offer imposes a fiduciary duty on the board of directors to analyze the offer to determine whether it is in the best interest of stockholders. That means the board will need to undertake a financial analysis of comparing the offer and its future impact to the likely future results of operations of your institution on a status quo basis. For our clients, we typically run the offer through our acquisition models along with running future growth scenarios for the institution to compare, on an apples to apples basis, whether stockholders of the target are better off accepting the offer from the other institution or maintaining their current stock ownership over the long-term.

However, even in taking those steps to analyze the offer and determine whether or not the board believes that offer is in the best interest of stockholders, the board does not have a duty to disclose the offer to stockholders at that point. In fact, the board could go through the complete financial and strategic analysis of whether to accept the offer and, if it ultimately decides to reject the offer, the stockholders really never need to know about it. For some of our clients that are frequent targets that may receive a handful of unsolicited offers throughout the year, the board has elected to have the president put in a typical letter to stockholders something to the effect of: "From time to time, the board of directors receives unsolicited offers from other institutions. To date, the board has not found any such offers to be in the best interests of stockholders and has not elected to pursue further discussions with those entities".

For a non-public company, stockholders need not be informed until a formal definitive agreement is executed between the parties. In that situation, most banks will then send out a letter to their stockholders on the day the formal binding definitive agreement is executed indicating to stockholders that an agreement has been reached with the other institution and that in the coming weeks stockholders will be receiving information to consider and vote on the proposal, etc. By that time, the board should have fully analyzed the offer, fully negotiated an agreement with the potential acquiror and have a deal that is truly in the best interest of stockholders so that the response from stockholders is fairly positive.

It is time to be prudent again when considering offers, whether solicited or unsolicited. We hope this provides you some guidance.