

# UNSOLICITED OFFERS: THE RULES, REAL LIFE, AND REAL LIFE UNDER THE RULES

Fourth in a series: How far can "no" go if money says "yes"?

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This is the fourth in my series of blogs on M&A matters for community banks. Blog #2 dealt with the issue of "What constitutes an unsolicited offer." Blog #3 dealt with the issue of "What does the board need to do when it actually receives an unsolicited offer, i.e. analysis."

This week's blog will give community bank boards some indication of their alternatives upon receipt of the analysis of an unsolicited offer.

Board must remember why it's there

A fundamental principle for this part of the discussion is that the community bank board's job is to make decisions that enhance the value for their shareholders. In this context, the question is:

Is what is being offered by the potential buyer to the community bank selling shareholders, e.g., stock or cash, better for the shareholders than continuing to hold the existing community bank holding company's stock?

Keep in mind, even if the answer to that is affirmative, it does not mean the board has to accept the offer.

It can negotiate the offer. It can look for other potential buyers. It can put the bank in play, any number of things.

A solid offer on the table generally means, then, that if the community bank holding company does not sell to that particular buyer, that it will sell to some entity. That's because the board has concluded that there is a situation in which the shareholders can be better off holding something other than the existing holding company's stock.

Is the offer better? If so, what next?

As noted in last week's blog, the board cannot simply "punt" the offer and the decision making to the shareholders. Decisions of this type are ones that are designed for the board to make.

The board is protected in its decision making process by the business judgment rule. That is, a court will not second-guess the board's decision as long as that decision was made in good faith without a disabling conflict and in reliance upon expert advice. The board needs to make the decision.

And please note, under the business judgment rule, the board has the right to be wrong.

As indicated in the previous blog, the board generally should commission a comparison of the bank's baseline performance without an acquisition against the performance of the stock to be received from the buyer in the hands of the selling shareholders post-acquisition. Typically, at least four measures are considered: earnings per share growth, return on equity, liquidity for the shares, and cash flow coming off the shares.

Let's assume the analysis is concluded and analysis determined that holding the stock of the potential buyer will be significantly more advantageous to the seller's shareholders than holding their own shares in the area of earnings per share growth, return on equity, liquidity for the shares, and cash flow.

Is this a no-brainer where the board simply has to accept the buyer's offer?

Not necessarily.

Dealmaking (with a heavy dose of reality)

In the real world, when that type of analysis comes back to the community bank board, there may be several different reactions.

• One reaction that generally comes from the CEO is that perhaps the original baseline numbers were "too conservative."

• One reaction that comes from the potential seller's board, particularly if the buyer's dividend is significantly higher than the seller's is, "Should we raise our dividend?"

• One reaction, if there is more liquidity in the buyer's stock and not much in the target's, is, "Should we engage in a stock repurchase program to provide share liquidity for our shareholders?"

In other words, if the board does not want to sell, directors will look for reasons to get "the numbers closer."

If the "economics" are close, then the board can generally look to other (non-financial) issues to determine whether or not the unsolicited offer represents a better situation for their shareholders than holding the existing stock.

Most community bank boards have (or should have) in their Articles of Incorporation a provision that allows the board of directors in an acquisition context to consider matters other than price, i.e. the economics of the transaction, when considering the acquisition offer.

However, the reality is that unless the economics are close--i.e., it is a tossup as to whether our shareholders would be better off holding our stock or the stock of the potential acquirer based on the financial analysis conducted--then the non-financial issues cannot be determinative.

Saying "no" when the numbers say "yes"

I have been in many boardrooms where the board has received and is considering the analysis with respect to an unsolicited offer where the analysis shows the unsolicited offer would put the target shareholders in a much better position.

In many of those situations, the board expresses a desire to make non-financial considerations determinative as a reason to turn down the unsolicited offer.

Different reasons surface in different situations: They do not like the personalities of the key people of the buyer; the buyer terminates employees when they do a deal; the buyer does not support the community, etc.

The general rule is that if the economics are not close, the board cannot take the position that the company is not going to sell to the unsolicited offeror because of non-financial reasons. In other words, the "soft issues" are not enough to kill a transaction unless the economics are close.

Five responses to weigh, carefully

If the economics are close, then what is the board to do? The directors can:

1. Readdress their strategic plan to make their stock more valuable. (This actually happens in many banks that have not fully developed their bank's potential.)

2. Accept the offer (like buying a new car at full list price.

3. Negotiate the offer with the unsolicited offeror.

4. Reject the offer out of hand--and thereby breach their fiduciary duty.

5. Hold the unsolicited offeror at bay while they begin to explore other opportunities, i.e. put the bank in play.

As noted in previous blogs, although hostile offers are infrequent, unsolicited offers or expressions of interest are, and they will become more frequent.

As a board of directors, the board does not need to be experts in acquisitions, but the board does need to some fundamental idea of how it should respond to various acquisition issues.

The next blog in this series will deal with the practical steps once a credible offer has been made and the board is interested--or forced to be interested--as a result of their fiduciary duty. Stay tuned!

You can also catch the article, "Don't slouch towards sale: Put your bank's best face forward for buyers" in the ABA BJ November 2012 Digital Magazine.

#### About Jeff Gerrish

Jeff Gerrish is chairman of the board of Gerrish McCreary Smith Consultants, LLC, and a member of the Memphis-based law firm of Gerrish McCreary Smith, PC, Attorneys. He is a frequent contributor to ABA Banking Journal and ABA Bank Directors Briefing, and frequently speaks at ABA events and telephone briefings.

Gerrish's consulting and law firms have assisted over 1,500 community banks in all 50 states across the nation since their formation in 1988. Gerrish formerly served as regional counsel for the Memphis regional office of the FDIC and with the FDIC in Washington, D.C. with nationwide responsibility for litigation against directors of failed banks. Currently, Gerrish's practice involves mergers and acquisitions, strategic planning, capital raising, and general consulting with community financial institutions

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