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MERGERS AND ACQUISITIONS

Role of Directors in the Acquisition Process

1. Board has responsibility for determining Bank's future
2. In fulfilling this responsibility, a prime goal of the Board is to protect and enhance shareholder value
3. Bank directors owe fiduciary duties to the Bank and shareholders they serve, including the duties of care and loyalty
    1. Duty of Care
        a. Directors have an obligation to act on an informed basis after due consideration of the relevant materials and appropriate deliberation, including the input of legal and financial experts.
        b. While a Board may use outside experts to advise it on significant legal and financial matters affecting their analysis, the Board may not delegate its central responsibilities - the duties of loyalty and care - to other decisionmakers.
    2. Duty of Loyalty
        a. In fulfilling its duty of loyalty, the Board must make its decision in the absence of self-dealing or conflicts of interest.
        b. If directors appear on both sides of, or derive an improper financial benefit from, a challenged transaction, a court will ignore the business judgment rule, discussed below, and place the burden on the Board to defend the challenged transaction by showing that it meets the requirements of "entire fairness" to the company and its shareholders.
        c. If a conflict exits, a director should disclose the conflict and not participate in the decision process. Further, the transaction must be fair to the corporation and its shareholders.
4. As a general rule, courts review corporate directors' decisions under the business judgment rule. Under the business judgment rule, directors are presumed to act, in the

absence of a disabling conflict, on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the corporation.

5. In reviewing a Board's actions, a court will generally review the **process** utilized by the Board in reaching a decision rather than the merits of the decision itself
6. Prior to receipt of takeover offer, Board should review Bank's strengths and weaknesses and establish a long term strategic plan
   a. In conducting this review, the Board should call upon the input of experts such as investment bankers to assist the Board in evaluating the Bank and its future potential
   b. In making strategic decisions, directors are not required, absent a Revlon duty discussed below, to restrict themselves to an immediate or other short-term time frame. Directors are entitled to select the transaction that they believe provides stockholders with the best long-term prospects for growth and value enhancement with the least amount of downside risk.
   c. In transactions not involving a change in control, the directors may appropriately consider the effect of the transaction on non-stockholder constituencies, such as the Bank's employees, its customers and the community in which it operates. Such constituencies are entitled to consideration at least on the basis that the realization of stockholder value is dependent in part upon them.
   d. Based upon the Board's review of the Bank's strengths and weaknesses, the Board should determine if the Bank should stay independent, adopt an acquisition policy, seek strategic merger partners or sell the Bank
7. If Board determines to remain independent, put in place appropriate corporate protections
   . Adopt antitakeover devices, such as classified or staggered Board terms, advanced notice by-laws, supermajority vote requirements and shareholder rights plans. Such devices, at a minimum, will provide Board with valuable time during which to evaluate a bid and determine the correct response. Devices such as shareholder rights plans can be effective in obtaining a higher price.
   a. Review charter to assure taking advantage of latest favorable state laws
   b. Review adequacy of indemnification provisions and D&O insurance
   c. Review compensation plans
      i. Adopt golden parachutes plans for key employees
      ii. Adopt tin parachute plans for lower level employees providing severance plans in the event of a takeover
      iii. Provide long term incentive plans to attract and retain key employees
8. Responding to unsolicited merger inquiries
   . Important not to respond in a frantic rush; takeovers take time and each decision must be carefully made

a. Designate one spokesperson and require that all communications with the public originate with that person

b. Consider appointing a small committee of disinterested directors to oversee the process

c. Assemble a working team consisting of financial and legal advisors. (Ideally, this team will have been identified long before a bid is received.)

d. If Board adopts antitakeover devices in response to the unsolicited bid, the Board's actions will be subject to "enhanced scrutiny". In general, the Board will be required to prove that it had reasonable grounds for believing that corporate policy and effectiveness were in danger and that the actions taken were reasonable in relation to the threat posed. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

9. Fiduciary Duties in the Sales Context

. Once the Board decides to sell a controlling interest in the company, the directors have a duty to achieve the highest value reasonably attainable for the stockholders

a. In effect, the Board's role changes from "defenders of the corporate bastion to auctioneers charged with getting the best price for stockholders at a sale of the company." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

b. There is "no single blueprint" that directors must follow in selling a company. *Paramount Communications Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994) ("QVC"). Rather, the Board has reasonable latitude in determining the method of sale most likely to produce the highest value for the stockholders. Any method chosen, however, that does not involve some form of a realistic market check may be difficult to sustain.

c. Factors may lead a Board to conclude that a particular offer, although "higher" in terms of price, is substantially less likely to be consummated. The directors "should analyze the entire situation and evaluate in a disciplined manner the consideration being offered. Where stock or other non-cash consideration is involved, the Board should try to quantify its value, if feasible, to achieve an objective comparison of the alternatives." *QVC*, 637 A.2d at 44.

10. Importance of Informed, Good-Faith Decisionmaking

. To avoid liability for their actions and to preserve a transaction in the face of competing bids, members of a Board must assume an active role in the decision process and remain fully informed throughout the process.

a. A Board that fails to participate actively in the decision to sell the company and rejects or accepts a proposed transaction without adequate information may not claim the protections of the business judgment rule.

b. Board should carefully document the basis for its decisions because a central inquiry is whether the Board acted on an informed basis.

c. When confronted with competing bids, crucial that Board act in good faith and after reasonable investigation.

. "Directors are not obligated to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy." *Paramount Communications Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1989).

i. However, as a practical matter, directors must be cognizant of the possibility that if a hostile suitor offering greater current value appears following announcement of a merger, obtaining stockholder approval for the merger may well be problematic. In addition, under such circumstances, any actions taken by the Board to defeat the hostile suitor will be judged by the enhanced Unocal standard.

ii. Further, long-term strategic and business concerns are irrelevant where the future strategy and synergies essentially will be out of the seller's stockholders' control. In such a situation, the Board should value the stock consideration, not based on expectation of future value enhancement, but as of the time it will be received by the seller's stockholders. *QVC*, 637 A.2d 34 (Del. 1994).

11. Investment Bankers' Fairness Opinions

. In its evaluation of a business combination proposal, a Board of Directors is entitled to rely on the expert advice of the company's legal and financial advisors as well as on the advice and analyses of management.

a. Such experts can provide important strategic advice to the Board and help the Board evaluate the complex legal and financial issues presented by the proposal.

b. The analyses and opinions presented to the Board of Directors, combined with presentations by management and the Board's own long-term strategic review, provide the key foundation for the exercise of the Directors' business judgment.

c. Particularly in change of control situations where directors are obligated to choose among competing common stock (or other non-cash) business combinations, the Board's decision making may be susceptible to claims of bias, faulty judgment and inadequate investigation of the relative values of competing offers.

d. Because the stock valuation process inherently involves greater exercise of judgment by the Board, consideration of the informed analyses of financial advisors will be helpful in establishing the fulfillment of the applicable legal duties.