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For questions regarding this guidance or to obtain an electronic copy, contact Dave Muchnikoff at 202-295-4513 or dave@sfttlaw.com or any other SFTT attorney with whom you have consulted in the past. Dave is a partner specializing in capital raising, mergers and acquisitions, and other corporate transactions. He is rated Preeminent AV by Martindale Hubbell and recently selected to the "Top Rated Lawyers in Securities Law" by The American Lawyer and by Corporate Counsel. He has been a guest speaker and written on capital raising, mergers and acquisitions, and corporate governance issues related to community financial institutions for the American Bankers Association and various state and regional banking associations. He is a former Assistant Branch Chief in the Division of Corporation Finance at the U.S. Securities and Exchange Commission, and certified public accountant.

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Silver, Freedman, Taff & Tiernan LLP
Our Knowledge and Judgment
Foster Speed and Results

A Community Banker's Pocket Guide to Mergers and Acquisitions

Volume II

Tel: 202-295-4513

This is the second installment of our pocket guide for bank directors and executive officers designed to highlight merger and acquisition ("M&A") considerations.

PLANNING CONSIDERATIONS.

Careful analysis of the estimated benefits and payments that will be received in a transaction under your benefit plans and employment contracts should be conducted well in advance of any actual transaction, preferably a year or more in advance. This review should include consideration of potential amendments of employment/severance agreements, stock benefit plans and employee stock ownership plans ("ESOP") to address a change in control if such agreements or plans are silent or do not provide adequate protection. The review of the stock benefit plans should include a review of voting provisions. Also review or consider the adoption of a general employee severance plan to cover employees without employment or severance agreements in the event of their severance at the time of or within one year of the change in control.

SECTION 280G.

In your review; the importance of Section 280G of the Internal Revenue Code, which applies to both public and private companies, cannot be overstated. Section 280G applies to:

- officers (three highest paid if less than 30 employees; up to 10% if between 31 and 490 employees);
- highly compensated individuals (more than $115,000 for 2014) in the top 1% of total employees; and
- shareholders who own more than 1% of your stock (this provision often applies to non-employee directors).

Section 280G requires that the present value of all payments in the nature of compensation that are contingent on a change in control be added together to determine whether they are "excess parachute payments". If the total amount of the change in control benefit equals or exceeds three times the employee's "base amount" (the average W-2 income of the employee for the five calendar years preceding the year in which the change in control occurs), the payments are considered "parachute payments," and the excess of the total amount of the parachute payments over the base amount are considered "excess parachute payments." Excess parachute payments are subject to a 20%, nondeductible tax penalty (payable by the employee) and are not deductible by the employer. As a result, an employment agreement that does not take into account the tax consequences of change in control benefits can be extremely costly to both the employer and the employee.

While there is no one-size-fits-all approach to avoiding Section 280G, you should review your executive compensation arrangements now to ensure that your executive team receives the payments it deserves without triggering tax penalties. The analysis should look at all the potential benefits that would be triggered or accelerated in a transaction including:

- potential severance benefits under employment or change in control severance agreements;
- accelerated vesting of stock options and/or restricted stock awards;
- accelerated vesting or payments under deferred compensation plans and supplemental executive retirement plans ("SERPs"); and
- terms of agreements- do they provide for a Section 280G cutback, Section 280G gross up or modified 280G cutback (no reduction if benefits after payment of excise tax, would exceed Section 280G cutback amount)?

All compensatory arrangements entered into within one year of a change in control, new equity grants or removal of performance criteria from prior grants and increased bonuses are presumed to be contingent on the change in control (even if by their terms they are not triggered by a change in control) unless this presumption is rebutted by clear and convincing evidence, such as a historical record of a pattern of equity grants at similar times and amounts. Section 280G considerations can be a factor in timing of closing of transaction; closing in January may allow some tax planning steps to be effected in the months immediately preceding closing while if the merger was completed in December, all tax planning actions would have had to be completed by the end of the prior December.

REGULATORY AND STATUTORY MATTERS; CORPORATE DOCUMENTS:

- Your articles of incorporation/charter and bylaws should be reviewed and potentially amended (which may require shareholder approval and if anti-takeover provisions are sought to be adopted, a significant amount of lead time) to provide adequate protection from an unwanted acquisition, the goal being to provide the Board with as much ability as possible to choose its destiny;
- Understand the anti-takeover protections included in your articles of incorporation/charter and bylaws, especially any business combination or "fair price" provisions;
- Review applicable corporate and banking regulations governing changes in control; and
- Understand your fiduciary duties (to be discussed in a subsequent guide) under applicable law.

CORPORATE GOVERNANCE AND RELATED MATTERS:

- Analyze your shareholder composition: know who owns your stock and consider ways of increasing board, management and employee stock ownership as a defensive measure to help protect against an unwanted acquisition. For example, public companies should consider amending their 401(k) plan if it does not provide for investment in your stock as well as to provide that any company match be in the form of company stock;
- Understand how institutional investors will react to the different courses of action that you may consider implementing;
- Analyze the potential M&A competition, buyers and sellers in your market area;
- Review your major vendor contracts; understand the termination clauses and how they will operate in a change in control; if negotiating new contracts, consider including provisions which reduce the termination cost in a change in control; and
- Review your shareholder communications; do they highlight the institution's performance and articulate the company's strategic goals making you more attractive as a potential buyer or seller.

Most of the above steps set forth above need to be taken well in advance of any potential transaction. If a seller, once you determine to no longer pursue independence or are faced with addressing an acquisition offer, your flexibility is substantially reduced.

The next guide will discuss hiring an investment banker and the initial M&A process.