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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
3299 K St, N.W.
Suite 100
Washington, DC 20007-4444

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

A Community Banker's Pocket Guide to Mergers and Acquisitions

Volume VII

Tel: 202-295-4513

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

Once the indication of interest is accepted, the buyer and the seller will work with their legal counsel to prepare the M&A definitive agreement ("Agreement") and other deal documents such as employment agreements and any voting agreements with directors, executive officers and large stockholders requiring them to vote in favor of the transaction. Buyer's counsel will typically prepare the initial draft of each document based on the indication of interest. Typically there are several revised drafts based on your and your lawyer's comments.

REPRESENTATIONS AND WARRANTIES

The Agreement will contain detailed statements in the form of "representations and warranties" about the seller's business that are intended to cover all of the areas that could potentially create liability for the buyer or otherwise reduce the value of the seller's business. Representations and warranties are very extensive for the seller. Besides typical contractual terms confirming the seller has the authority and consents required to enter into the Agreement, and that entering the Agreement does not conflict with other seller agreements, the seller will confirm its capitalization and outstanding equity awards. The seller will also confirm through its statements that it has:

- no issues with its financial statements;
- ownership or valid leases and licenses to its real, personal and intellectual property;
- no environmental problems;
- no contract disputes with third parties;
- complied with applicable laws and regulations and there are no outstanding regulatory matters; and
- submitted all governmental reports and filings, including SEC reports, if any, and tax returns, truthfully and timely.

The seller will describe on "disclosure schedules" provided to the buyer if there is an exception to any of its representations.

In addition, there are usually representations and warranties, which require the seller to list in its disclosure schedules all of its material contracts, any material legal proceedings, all of its material governmental permits or agreements, any material transactions with directors, executive officers and large stockholders, and all of its employee benefit plans.

Representations and warranties, including disclosure schedules supplement the buyer's prior due diligence and sometimes reveal issues that must be dealt with prior to closing and which may give the buyer grounds to renegotiate the purchase price or other deal terms. In addition, there is typically a "bring down" closing condition that entitles the buyer to walk away from the transaction if the seller's business changes between signing and closing and, as a result, the representations and warranties (which are made as of signing of the Agreement), no longer are true and correct as of the closing. As a result, the representations and warranties affect the certainty of closing the transaction.

Buyer representations and warranties may be as extensive as the seller's depending on whether stock is involved and the relative equity position of the seller. In addition to the representations and warranties described above, the buyer will state that it has the financial ability to pay the cash portion of the merger consideration.

Highly negotiated within the representations and warranties are actual or constructive (knew or should have known) "knowledge" qualifiers or carve-outs making the seller responsible for misrepresentations that the seller, through its management, knew or should have known, and may also require "due inquiry," meaning management must investigate prior to affirming the representation. In addition, many representations will contain "Materiality" and "Material Adverse Effect" qualifiers or carve-outs that excuse the seller for not disclosing items that are not "material" to the seller or would not result in a "Material Adverse Effect" on the business, properties, results of operations or financial condition of the seller. Seller's counsel should include as many qualifiers and carve-outs as possible to minimize the extent of the disclosure schedules and to minimize risks to closing the transaction, and for closely held sellers, limit potential indemnification obligations.

COVENANTS

The seller will commit in the Agreement to continue to run its business in accordance with its existing lending, investment and other policies and in the ordinary course business consistent with past practice, including:

- limiting loan originations and modifications above a specified dollar amount;
- making no material changes to its deposit mix or the rate of interest paid on time deposits or on certificates of deposit; and
- not materially increasing FHLB or FRB borrowings.

The seller will also agree not to modify, amend, renew or terminate any material contract, employment, consulting, severance, change in control, or similar agreement or benefit plan to avoid creating future obligations for the buyer. Future dividend payments until closing would be limited to regular dividends.

As a seller, it is important to not permit unduly restrictive oversight by the buyer which may trigger control issues with banking regulators or restrictive limitations on the operations of your institution pending the completion of the transaction as you must be prepared for the "what if" in case the transaction fails to close.

Additionally, the seller will promise not to solicit third parties for a better offer, recommend transaction to stockholders and typically commit to have each of its board members (and occasionally executive officers and/or large shareholders) enter into a voting agreement to vote shares they own in favor of the M&A transaction, and/or enter into a non-compete/solicitation/resignation agreements effective upon closing.

Non-compete/solicitation agreements protect the buyer by prohibiting contact with the seller's customers and employees and establishing or working for a competitor within a specified geographic area for a period typically of one-to two years after closing. These agreements are highly negotiated and are subject to compliance with applicable state law and court cases. Similar provisions may be contained in the employment agreements entered into by management retained by the buyer.

Buyer covenants typically relate to the filing of required regulatory application and any SEC registration document on a timely basis; honoring of existing employment benefit arrangements; the appointment of board members and senior officers and maintaining indemnification insurance for officers and directors.

The next guide will address potential break-up fees, indemnification for closely held companies, and the closing conditions in a M&A Agreement.