Views & Visions

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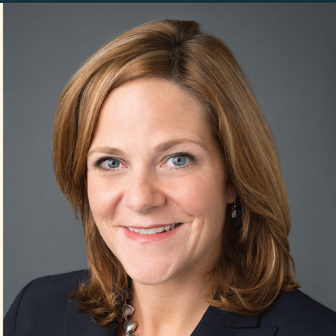

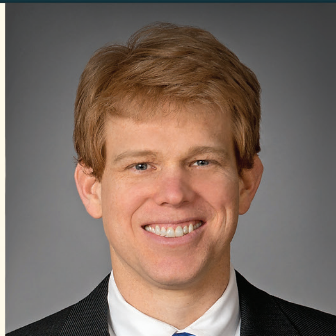

Issues to Consider When Pursuing a Deal

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Amy J. Tawney is a partner in the Charleston office of Bowles Rice and focuses her practice on banking law, mergers and acquisitions, securities law and regulatory matters.

She advises banking clients on compliance with federal and state regulations, corporate governance issues, compliance with securities laws and drafting loan documentation for corporate loan transactions.

Her merger and acquisition practice involves structuring, documenting and managing mergers, acquisitions, reorganizations and other corporate transactions.

She also provides general corporate services to all sizes of businesses including assistance with business formation, commercial lease and contract review and venture capital and other private financing.

Ms. Tawney earned a bachelor's degree from West Virginia Wesleyan College and her law degree from the West Virginia University College of Law. She has been recognized by *The Best Lawyers in America, Chambers USA* and *Super Lawyers*. She is a member of Bowles Rice's executive committee.

Benjamin R. Thomas is a partner in the Charleston office of Bowles Rice and focuses his practice in the areas of commercial and financial services and mergers and acquisitions. He is experienced in advising businesses on various structural matters related to acquisitions and entity formation and general corporate governance matters.

Mr. Thomas earned a bachelor's degree, *magna cum laude*, from the University of Notre Dame and a law degree from Washington & Lee University School of Law.

He is recognized by *Super Lawyers* as a Rising Star in banking. He serves as Bowles Rice's recruiting coordinator.

In recent years, corporate practitioners have anticipated a wave of transactions in the financial services sector spawned by tightening margins and an increasingly cumbersome regulatory environment. Regardless of whether the anticipated wave hits in 2016, financial institutions can benefit from knowing what to expect when evaluating or pursuing an acquisition or sale.

Transaction Structure

An initial consideration for the acquiror is how to structure the transaction. Generally, both parties seek to qualify the transaction as a tax-free reorganization under federal law. This goal can be accomplished through a bank to bank merger, a forward triangular merger or reverse triangular merger.

In a straight bank merger, the target bank merges into the acquiring bank and the target bank's shareholders receive the acquiring bank's stock, while the acquiring bank receives all of the target bank's assets and assumes all of its liabilities. At least 40 percent of the consideration must be the acquiror's stock to qualify for a tax-free reorganization.

In a forward triangular merger, the target is merged into the acquiror's first-tier subsidiary and the target's shareholders receive holding company stock, while the acquiror's subsidiary acquires the target's assets and assumes its liabilities. To qualify for tax-free treatment, the acquiror must own at least 80 percent of each class of the subsidiary's stock and the acquiror's subsidiary must acquire substantially all of the target's assets — generally, at least 90 percent of the target's net assets and 70 percent of its gross assets (referred to as the 90/70 requirement).

In a reverse triangular merger, the acquiror's subsidiary is merged into the target and the target survives, which might be desirable if the target has better name recognition or holds valuable licenses. To qualify for tax-free treatment, the 90/70 requirement must be satisfied and the holding company must acquire control of the target solely in exchange for holding company voting stock. This means that at least 80 percent of the consideration must consist of holding company voting stock.

If the parties are not concerned about structuring the transaction as a tax-free reorganization, then the acquiror should consider structuring the transaction as a purchase and assumption to obtain the tax benefits associated with the structure.

Key Provisions

Customarily, a financial institution's management team and its financial and legal advisors will negotiate the terms of the definitive merger agreement.

A target should focus its attention on the strength of the deal protections and the terms of the exclusivity clauses, which restrict the target's ability to shop itself or respond to indications of interest from other interested suitors. Target directors must comply with their fiduciary duties to their shareholders, which could mean responding to other offers from interested parties or actively shopping the target after the transaction is announced. It is common for a target to agree to pay a termination fee if it pursues another transaction other than the transaction contemplated in the merger agreement.

The parties should pay attention to the provisions that will govern their conduct during the pre-closing period. A transaction proceeds more smoothly if the parties have a shared action plan with respect to satisfying conditions to closing, including expectations for when necessary regulatory applications will be filed.

Benefits for continuing employees, severance arrangements for potentially terminated employees and compensation payable to target executive officers in the transaction should also be addressed in the agreement. Typically, due diligence will continue up until the merger agreement is signed. Material issues identified during due diligence should be factored into the parties' negotiations of the merger agreement.

Regulatory Filings

The acquiror's primary regulators and the structure of the transaction will dictate what regulatory applications must be filed in connection with the transaction. The parties should consider the risk of receiving a public comment on the application or being obligated to provide additional information to the regulators in order to complete the application, both of which delay approval of the applications by the regulators. We recommend reaching out to the regulators on a confidential basis to discuss any issues that the regulators may want to address in the approval process. The regulators will expect the acquiror to produce the results of its due diligence and any plans for remediation and integration plans. Regulatory applications should also address consumer compliance, CRA, BSA/AML and the effects of the transaction on competition.

If the merger consideration involves stock, the parties must also consider the registration requirements under the federal and state securities laws. In a bank to bank merger, the stock of a bank is generally exempt from SEC registration; however, the disclosure obligations to shareholders in connection with the transaction are similar to the SEC rules. If the merger consideration involves stock of a holding company, then the SEC and state blue sky registration rules apply to the issuance of the stock to the target shareholders. A holding company is required to file a Form S-4 to register the shares being issued to the target shareholders in the merger. After the holding company's registration statement is declared effective, it is subject to the Exchange Act reporting obligations under Section 15(d) of the Exchange Act of 1934, as amended. The SEC has indicated in an interpretation that registration on Form 1-A under Regulation A+ is also permissible in connection with merger and acquisition transactions. V