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Circling the Wagons: Has the Scope of the Duties of Bank Directors Faced with Bids for Acquisition Expanded?

I. INTRODUCTION

The 1980's and 1990's have been characterized by increased levels of merger, acquisition, and takeover activity.\(^1\) While this trend has affected many sectors of the economy, it has been especially pronounced in the banking and finance industry.\(^2\) Merger and acquisition are often sound strategies for addressing the primary goals of banks: growth into new geographic markets, development of new product areas, and response to threats from business competitors.\(^3\) As growth has become more crucial to survival, the incidence of mergers and takeovers in the banking arena has increased.\(^4\) The fact that over two-fifths of the industry's participants have been acquired since World War II underscores the effect that this trend has had on the industry.\(^5\)

The acquisition of small and medium-sized community banks\(^6\)

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1. See Devra L. Golbe & Lawrence J. White, Mergers and Acquisitions in U.S. Economy: An Aggregate and Historical Overview, in MERGERS AND ACQUISITIONS 25 (Alan J. Auerbach, ed., 1988) (stating that there have been other periods of high activity, including the late 1960's); Steven Lipin, Murphy's Law Doesn't Apply: The Conditions are Perfect for Continued Growth in Mergers, WALL ST. J., Jan. 2, 1998, at R6 (stating that this trend was especially pronounced in the mid 1990's).
3. See JOHNSON, supra note 2, at 4-7.
4. See id. at 4. The number of banks in the United States decreased by roughly one-third from the mid-1970's to the-mid 1990's. See id. at 1-2. Over this same period, the number of bank mergers per year has increased from around 100 to over 500 per annum, peaking at around 800 in 1988. See id. at 3.
has proven to be an excellent means of increasing deposits, branch infrastructure, and general market share.\(^7\) In this type of environment, unsolicited bids for the acquisition of community banks are not unusual.\(^8\) The options and duties of the directors of a community bank in responding to an unwanted overture is an issue which, if it has not already been a topic before a community bank’s board of directors, is likely to arise in the future.

The primary source of a director’s responsibility springs from the common law,\(^9\) though duties of directors have been codified in most states.\(^10\) The boundaries of a director’s duty are defined by the duties of care\(^11\) and loyalty.\(^12\) The board owes these duties to the corporation and derivatively to the shareholders.\(^13\) While the duties of care and loyalty are crucial in defining most facets of a director’s obligations, they are especially important in the realm of mergers and acquisitions.\(^14\)

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\(^8\) See generally Cameron, supra note 7; Covington & Ellis, supra note 7; Johnson, supra note 2.

\(^9\) See Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 179-82 (Del. 1986) (holding that the ultimate responsibility for managing a corporation falls on the directors); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (holding that directors owed an “unyielding fiduciary duty” to the corporation requiring prudence and due care); Singer v. Magnavox, 380 A.2d 969, 976-77 (Del. 1977) (holding that the directors and management of Magnavox owed the corporation a fiduciary duty during a merger); Loft, Inc. v. Guth, 2 A.2d 225 (Del Ch. 1938), aff’d, 5 A.2d 503 (1939) (holding that the president of a corporation owes that corporation a fiduciary duty, and is prohibited from diverting corporate assets or opportunities for personal use); Wilson v. McClenny, 136 S.E.2d 569 (N.C. 1964) (promoters of an as yet unformed corporation owe it the same fiduciary duty as a properly formed corporation).


\(^11\) See infra notes 42-92 and accompanying text.

\(^12\) See infra notes 42-92 and accompanying text.

\(^13\) See James D. Cox, Corporations § 10.1 (1997). Generally, the directors’ duties amount to a requirement that they serve in “good faith,” exercise the care a reasonable, prudent person in a similar situation would exercise, and refrain from competing with or taking advantage of the bank. See id. See also Russell M. Robinson, III, Robinson on North Carolina Corporation Law §14-1 (5th ed. 1995).

\(^14\) See Cox, supra note 13, § 23.1; Robinson, supra note 13, §14-1.
A board of directors faced with an unwanted bid for acquisition may have additional considerations over and above those relating to shareholders.\textsuperscript{15} It is possible that a board of directors could consider a deal’s potential for causing a decline in overall service or commitment to the community. Though this “duty to the community” is probably subordinate to the directors’ duty to the shareholders,\textsuperscript{16} many community banks have nevertheless established close ties with their surrounding communities or have adopted strong supporting roles in their broader communities.\textsuperscript{17} Whether, and under what circumstances, a board of directors may consider broader constituency, or stakeholder, interests during bids for acquisition is somewhat unsettled.\textsuperscript{18}

The assertion that consideration of broader constituencies rises to the level of an affirmative duty could conceivably be supported in three ways. First, the “duty to the community” approaches the level of an affirmative duty when it has been drafted into the bank’s charter or into provisions of the bylaws that are approved by shareholders.\textsuperscript{19} Second, federal legislation, such as the Community Reinvestment Act (CRA), requires community involvement and has made a bank’s involvement in the immediate community (primarily involvement through lending activity) an important factor affecting several facets of the bank’s operations, including mergers and acquisitions.\textsuperscript{20} Finally, a history of service to the community may define a bank’s “corporate culture,” raising a theoretical argument of community reliance.\textsuperscript{21}

This article will first present a general review of the options and duties of a board faced with an unwanted bid for acquisition.\textsuperscript{22} It

\textsuperscript{15} See infra notes 93-127 and accompanying text. Some relevant case law and many states’ statutes suggest that directors are allowed to consider broader constituencies. See James J. Hanks, Jr., Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification, 43 BUS. LAW. 1207, 1227-30 (1988) (discussing “non-stockholder-constituency” statutes); R. Cammon Turner, Shareholders vs. the World, BUS. LAW TODAY, Jan./Feb. 1999, 32-35. See also Dennis Block et al., The Business Judgement Rule: Fiduciary Duties of Corporate Directors 330-39 (4th ed. 1993).

\textsuperscript{16} See Hanks, supra note 15, at 1227-30.

\textsuperscript{17} See Williams Remarks, supra note 6.

\textsuperscript{18} See Block et al., supra note 15, at 330.

\textsuperscript{19} See infra notes 108-17 and accompanying text.

\textsuperscript{20} See infra notes 118-23 and accompanying text.

\textsuperscript{21} See infra notes 124-27 and accompanying text.

\textsuperscript{22} See infra notes 24-92 and accompanying text.
will then question whether a duty to a broader constituency exists in the case of bank mergers.\textsuperscript{23}

II. RESPONDING TO A BID FOR ACQUISITION

A board of directors that has received an offer for acquisition has several options. The first is simply to accept the offer.\textsuperscript{24} A second option is for the bank to “put itself in play.” That is, the board may decide to seek out other potential suitors in an attempt to maximize purchase price, and thus, the return to shareholders.\textsuperscript{25} Once a bank, or any corporation for that matter, has made this decision, it usually cannot be reversed.\textsuperscript{26} If a bidding auction between two or more bidders erupts after the bank has been put in play, price becomes the only factor that the board can legitimately consider.\textsuperscript{27} Once a bank has become the subject of an auction or bidding war such that its sale is imminent, the directorate’s sole duty becomes securing the highest possible price for the corporation.\textsuperscript{28} Accepting an offer which is not the highest available\textsuperscript{29} or unfairly favoring one side over another during negotiations can be grounds for a shareholder-initiated lawsuit.\textsuperscript{30}

\textsuperscript{23} See infra notes 93-127 and accompanying text.

\textsuperscript{24} See generally Jeremy Bacon, \textit{The Role of Outside Directors in Major Acquisitions or Sales}, 180 CONFERENCE BOARD RESEARCH BULLETIN 8-14 (1985); Randall Mørck et al, \textit{Characteristics of Targets of Hostile and Friendly Takeovers, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES} 101, 105-13 (Alan J. Auerbach ed. 1988) (describing characteristics of organizations which tend to resist bids for acquisition); Rose, \textit{supra} note 5.


\textsuperscript{26} See Revlon, 506 A.2d at 176. See also BLOCK ET AL., \textit{supra} note 15, at 267-69; COX, \textit{supra} note 13, § 23.7.

\textsuperscript{27} See BLOCK ET AL., \textit{supra} note 15, at 266-69; COX, \textit{supra} note 13, § 23.7. See also Turner, \textit{supra} note 15, at 32-33.

\textsuperscript{28} See Revlon, 506 A.2d at 184; BLOCK ET AL., \textit{supra} note 15, at 266-69. This is known as the “Revlon rule” or “Revlon moment.” See COX, \textit{supra} note 13, § 23.7. The Revlon Rule applies in situations where a bidding war has erupted. See id. Once the sale of the bank becomes inevitable (this is referred to as the “Revlon Moment”), the board of directors assumes the role of auctioneer and is charged with securing the highest possible price for the corporation. See id.

\textsuperscript{29} See Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985) (holding that directors had improperly researched the question of what was a fair price for their corporation when they had relied on only one 20 minute presentation by an interested party).

\textsuperscript{30} See Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1286-87 (Del.
A third option the board of directors may consider is the decision to reject the offer and remain independent for the short to mid-term.\footnote{31} If the decision to reject an overture is made, the bank will typically adopt a "Don’t Tread on Me" posture so that potential future acquirers are apprised of the bank’s commitment to independence.\footnote{32} This response typically involves the implementation of "legal teeth" to support and make more meaningful the decision to remain independent.\footnote{33} These “teeth” include any number of anti-takeover measures that may be employed to discourage unsolicited overtures. Common defense measures include “poison pills,”\footnote{34} charter defenses,\footnote{35} “golden parachutes,”\footnote{36} “white knight” strategies,\footnote{37} as

1989) (allowing differing treatment of bidders, so long as directors are fair and have the shareholder’s best interests in mind).


33. See Cox, supra note 13, § 23.4 (describing responsive and preventive defensive measures).

34. See Block et al., supra note 15, at 519-24; Herzl & Shepro, supra note 32, at 76; Edward P. Welch & Andrew Turezyn, Folk on the Delaware General Corporation Law § 141.2.6 (1999). See generally Joy M. Bryan, Corporate Anti-Takeover Defenses: The Poison Pill Device (1995). “Poison Pill” is a common nickname for stockholder rights plans. See Cox, supra note 13, § 23.6. Such plans are designed to make stock prohibitively expensive to a potential unwanted purchaser. See id. The use of proactive defenses (i.e., ones not designed to respond to a particular overture) such as the “poison pill” was upheld in Moren v. Household International, Inc., 500 A.2d 1346 (Del. 1985).


36. See Block et al., supra note 15, at 637; Cox, supra note 13, § 9.18. Hefty severance packages for upper management, or “golden parachutes” as they are known in the parlance of takeover jargon, can be used to eat into cash reserves that an acquirer may be counting on to finance the purchase. See Block et al., supra note 15, at 637; Cox, supra note 13, § 9.18.

37. See Cox, supra note 13, § 23.4. “White knights” are welcomed, friendly suitors
well as the many regulatory impediments to bank mergers.\textsuperscript{38}

Regardless of the option the board ultimately chooses, the
decision must be based on a sound and objective analysis of the
benefits and risks to the corporation.\textsuperscript{39} The driving force behind this
analysis is the director's fiduciary duty to the corporation and to the
shareholders.\textsuperscript{40} Failure to make the decision based on the
corporation's and the shareholders' best interests will expose a director
to liability.\textsuperscript{41} Because the duties of directors play a crucial role in
defining their options when faced with an unwanted overture, an
analysis of those duties follows.

\textsuperscript{38} The primary regulatory impediment is found at 12 U.S.C. § 1828(c)(2) (1994).
The section states:
No insured depository institution shall merge or consolidate with any
other insured depository institution or, either directly or indirectly,
acquire the assets of, or assume liability to pay any deposits made in,
any other insured depository institution except with the prior written
approval of the responsible agency, which shall be—the Comptroller
of the Currency if the acquiring, assuming, or resulting bank is to be a
national bank or a District bank; the Board of Governors of the
Federal Reserve System if the acquiring, assuming, or resulting bank
is to be a State member bank (except a District Bank); the Corporation
if the acquiring, assuming, or resulting bank is to be a State
nonmember insured bank (except a District bank or a savings bank
supervised by the Director of the office of Thrift Supervision); and the
Director of the Office of Thrift Supervision if the acquiring, assuming,
or resulting institution is to be a savings association.

\textsuperscript{39} See generally Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del.
1985) (holding that the board of directors has an obligation to determine whether the offer
is in the best interests of the corporation and its shareholders).

\textsuperscript{40} See Unocal, 493 A.2d at 955 (stating that the analysis of the board's actions to
prevent a takeover begins with the basic principle that directors have a fiduciary duty to
act in the best interests of the corporation and its stockholders) (citing Guth v. Loft, Inc. 5
A.2d 503, 510 (1939)). See also infra notes 42-81 and accompanying text.

\textsuperscript{41} See Gilbert v. Bagley, 492 F.Supp. 714, 737 (M.D.N.C. 1980) (holding that
directors are not excused from shareholders' claims of breach of fiduciary duty).
III. DUTIES OF THE BOARD OF DIRECTORS

A. The Fiduciary Duty to Shareholders

The fiduciary duty of corporate directors springs from the common law. Directors are held to standards established by state law in civil cases. Most states have codified the common law duty under the Corporations sections of their statutes. The duty of directors is thus both a statutory and a common law duty.

The directors’ duty is generally divided into two parts: the duty of care and the duty of loyalty. These duties require a director


43. See Atherton v. F.D.I.C., 117 S.Ct. 666, 674 (1997) (holding that any federal common law addressing the standard of care owed by a bank’s board of directors did not survive Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938)).

44. See DEL. CODE ANN. tit. 8, § 141 (1991); N.C. GEN. STAT. §55-8-30 (1997).


47. See infra notes 42-88 and accompanying text. See also BLOCK ET AL., supra note 15, at 51-52; KNEPPER & BAILEY, supra note 46, § 1.04; THOMPSON, supra note 46, § 2.2.

Some confusion exists over where the boundary between the duty of care and the duty of loyalty lies. See Hanks, supra note 15, at 1212 (stating, “the Delaware Supreme Court itself has had difficulty in distinguishing the duty of care from the duty of loyalty”). See generally Ivanhoe Partners v. Newmont Min. Corp., 535 A.2d 1334, 1345 (Del. 1987) (discussing the difference between the duties of care and loyalty in the context of a lawsuit by a hostile bidder to stop anti-takeover measures employed by a target corporation); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (describing the court’s process for examining the extent to which a business transaction satisfies the duties of care and loyalty). A decision which satisfies the duty of care is made when directors have “followed an appropriately deliberative process.” Hanks, supra note 15, at 1212. A decision conforms to the requirements of the duty of loyalty when it is “made by directors with no financial interest in the transaction adverse to the corporation.” Id. See also WELCH & TUREZYN, supra note 34, § 141.2.1.1. The duty of loyalty requires that the director’s duties be discharged in a manner believed to be in the best interest of the corporation and its shareholders. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (citing Guth v. Loft, Inc., 5 A.2d 503, 510 (1939)). The central theme of this duty is that a director is prohibited from competing with the bank. See Cox, supra note 13, § 10.12. Directors are required to resolve the conflict between duty and self-interest in favor of the bank. See id.
to be diligent and honest in administering the bank's affairs; to place
the interests of the bank above her own; and to ensure that transactions
between the director and the bank take place on terms that are fair to
the bank. Though it seems obvious, directors may only authorize
bank activities that are legal. Directors are generally held to a gross negligence standard in
fulfilling their duties. In *Atherton v. FDIC*, the U.S. Supreme
Court held that the Financial Institution Reform, Recovery, and
Enforcement Act of 1989 (FIRREA) sets a gross negligence standard
as the minimum standard of care for directors. The FIRREA gross
negligence standard does not, however, "stand in the way of a stricter
standard that the laws of some States provide." The standard of care
which directors of state and federally chartered banks owe is,
therefore, set by State law, though it must be at least a gross
negligence standard. Although *Atherton* helped to clarify the standard
of care owed, some doubt remains as to whether the question has been
entirely settled.

Not all transactions between a director and the bank constitute a conflict of
interest; in fact, some might be advantageous to both parties. See *Robinson*, supra note 13, §14-4. Transactions between directors (some of whom may be among the bank's best customers) and their banks do not automatically violate the duty of loyalty. See *id.* Federal Reserve System Regulation O addresses this issue. See 12 C.F.R. §§ 215.4-215.5 (1998). Regulation O allows banks to extend credit to insiders only when certain
conditions are met. See *id.*

48. See *Cox*, supra note 13, § 10.12; *Knepper & Bailey*, supra note 46, §§ 1.04-
1.06; *Robinson*, supra note 13, § 14-4.
50. See, e.g., *Atherton* v. FDIC, 117 S.Ct. 666 (1997) (holding that a federal statute
addressing the standard of care owed by bank directors and officers does not preempt state
statutes, but rather establishes a ground floor standard for director negligence).
51. See *id.*
53. See *Atherton*, 117 S.Ct. at 674; Smith v. Van Gorkom, 488 A.2d 858, 873 (Del.
1985).
54. See *Atherton*, 117 S.Ct. at 674.
55. See, e.g., N.C. GEN. STAT. § 55-8-30(a)(2) (1990) (requiring directors to exercise
the care that "an ordinarily prudent person in a like position would exercise under similar
circumstances").
56. See *Atherton*, 117 S.Ct. at 674.
The foundation case establishing the duties of a directorate attempting to thwart an unwanted bid for acquisition is *Unocal Corp. v. Mesa Petroleum Co.* 58 *Unocal* was modified by *Paramount Communications, Inc. v. Time, Inc.* 59 *Unocal* has also been supplemented by the decision of the Delaware Supreme Court in *Revlon, Inc. v. MacAndrews & Forbes Holdings.* 60 These cases are applicable in the general realm of corporate law, and thus to the more narrow field of banking law.

*Unocal* laid out a two pronged analysis for assessing director duties. 61 In the first prong, the court must determine whether there was some basis to conclude that a valid corporate purpose was served by the defensive measure taken. 62 The board satisfies this step by making a showing of "good faith and reasonable investigation." 63 Generally, the more significant the issue, the greater the level of care that should be exercised in prosecuting an investigation. 64 The crux of this duty, especially as it applies to a bid for acquisition or merger, is that a director may not make decisions without an understanding of what the particular ramifications of a decision will be and without believing that those ramifications are in the best interest of the corporation. 65 A director is required to investigate any reasonably foreseeable answer to the issue at hand. 66 In the context of a bid for acquisition, it has been held that a proper analysis or "reasonable investigation" of an offer cannot take place absent consideration of the price being offered. 67

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58. 493 A.2d 946 (Del. 1985).
59. 571 A.2d 1140 (Del. 1989).
60. 506 A.2d 173 (Del. 1986).
61. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985); *BLOCK ET AL.*, supra note 15, at 237; *COX*, supra note 13, § 23.5.
62. See *Unocal*, 493 A.2d at 955.
63. *Id.* (quoting *Cheff v. Mathes*, 199 A.2d 548, 554-555 (1964)). See also *COX*, supra note 13, § 23.5.
64. See, e.g., *In re Fort Howard Corp. Shareholders Litig.*, C.A. No. 9991 (Del. Ch. 1988) (explaining that a sale in which control of the corporation changes hands presents a more significant issue than regular sales of stock to shareholders requiring more information, because it is more likely to alter the corporation's profitability).
66. See *UIS, Inc. v. Walbro Corp. et al.*, C.A. No. 9323, slip op. at 5-6 (Del. Ch. 1987).
67. See *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 257 (7th Cir. 1986) (holding that a proper analysis of an offer cannot take place without a consideration of the offering price). But see *Smith v. Van Gorkom*, 488 A.2d 858, 874 (Del. 1985)
The second prong of the Unocal analysis requires the court to ask whether the defensive measure employed by the board was reasonable, given the threat to the corporation.\(^6\) Unocal, however, left some doubt as to what exactly constitutes a reasonable measure under the test.\(^6\) This gray area has been greatly diminished by the Delaware Supreme Court's decision in Paramount Communications, Inc. v. Time, Inc.\(^7\)

Paramount addressed the question of what constitutes a reasonable response to the threat posed by a bid for acquisition.\(^7\) A central holding of Paramount is that defensive anti-takeover measures employed by a board are presumed to be reasonably tailored to the threat posed, so long as they are not calculated to completely block any and all bids for acquisition.\(^7\) Paramount, in effect, holds that the second prong of the Unocal analysis is satisfied so long as the defensive measures employed would not block every potential takeover bid.\(^7\) This is a substantial qualification of the rule of Unocal. In the final analysis, a board is really only required to satisfy the first prong of Unocal.\(^7\)

The rule in Unocal has been supplemented by another important Delaware case, Revlon, Inc. v. MacAndrews & Forbes Holdings.\(^7\) Revlon has been described as "a significant qualification of Unocal."\(^7\) Revlon does not replace Unocal, but rather acts to modify it under certain circumstances.\(^7\) When a corporation

\(^{68}\) See Unocal, 493 A.2d at 955.

\(^{69}\) See Cox, supra note 13, § 23.5. One interpretation held that the court is required to examine every defensive measure employed by the target corporation and balance it against the threat posed. See id. A more lax interpretation presumed that the board's defensive measures were reasonable in relation to the threat posed, so long as there was a showing of good faith and reasonable investigation in the first prong. See id.

\(^{70}\) 571 A.2d 1140 (Del. 1989).

\(^{71}\) See Block et al., supra note 15, at 267-68.

\(^{72}\) See Cox, supra note 13, § 23.7. The court in Paramount found that the threat posed to Time's long-range plan and the potential for shareholder confusion was sufficient to require the defensive response Time undertook. See id. This is significant because it means there are factors other than inadequate offering price that pose a threat sufficient to require a defensive measure. See id.

\(^{73}\) See Cox, supra note 13, § 23.7.

\(^{74}\) See id.

\(^{75}\) 506 A.2d 173 (Del. 1986).

\(^{76}\) Cox, supra note 13, § 23.7.

\(^{77}\) See id. There are three scenarios under which Revlon might be applied: (1) When
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encounters these particular circumstances, it is sometimes described as having entered the "Revlon Moment." This occurs when the sale or break-up of the corporation becomes imminent. Once a corporation enters the "Revlon moment," the sole duty of the board is to maximize the price received for the company. Since price becomes the only factor that can be considered in choosing a buyer, the board of directors is often described as adopting the role of auctioneer when in this situation.

B. The Business Judgment Rule

Directors are not always able to accurately predict what the effects of a particular decision might be. The board is insulated from liability resulting from "poor decisions," so long as it relied on a valid business reason to support its decision regarding the particular matter. This is known as the Business Judgment Rule. The Business Judgment Rule does not in any way alter or replace the duties of the director; rather the rule qualifies these duties.

the target bank initiates an active bidding process designed to "put the company in play," with the company's sale becoming imminent; (2) When the target corporation abandons its long-range plan and pursues a shorter-term plan to break up the company; or (3) The target board adopts a plan designed to alter who is controlling the corporation. See id.

78. See Cox, supra note 13, § 23.7.
80. See Revlon, 506 A.2d at 182.
81. See Cox, supra note 13, § 23.7.
82. Though it is by no means a black letter rule, courts generally apply a stricter standard to business decisions that affect the ownership of the corporation than to decisions affecting its operation. See Block et al., supra note 15, at 233; Robinson, supra note 13, § 14-6 (1995). A board is technically insulated from liability for decisions made during an acquisition, so long as there was a valid business reason for that decision. See Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984) (holding that board was insulated from liability when it had thoroughly and objectively reviewed an acquisition).
83. See Block et al., supra note 15, at 3. In Delaware, the business judgment rule has been codified at Title 8, Section 141(a) of the Delaware Code. In North Carolina, it is a product of the common law. See Robinson, supra note 13, § 14-6. There are multiple interpretations of the business judgment rule, including the Delaware Business Judgment Rule, the American Legal Institute Business Judgment Rule, and the Model Business Corporation Act Business Judgment Rule. See Block et al., supra note 15, at 43. See also R. Franklin Balotti & James J. Hanks, Jr., Rejudging the Business Judgment Rule, 48 Bus. Law. 1337 (1993).
84. See Revlon, 506 A.2d at 180 (citing Aronson v. Lewis, 473 A.2d 805, 812
A board will often not have the time or training to assess every critical decision itself. This is especially true when it is faced with a bid for acquisition. In such situations, directors are entitled to rely on the opinion of an expert who is more knowledgeable about a particular area or problem. This is known as the right of reliance. This right, unlike the bulk of the director's bundle of duties, is a statutory creation rather than a product of the common law.

C. Application of the Directors' Duties

The primary way a board of directors observes its duty, whatever the applicable standard of judicial review, is by maximizing the value of the shareholders' investment. In order to reject a particular overture, the board must make a determination, in good faith and after exercising due care, that the benefits of the acquisition are outweighed by its threat to current and future goals. This analysis usually hinges on price.

The board of directors is, however, also likely to entertain concerns other than price. One possible consideration that could enter into the equation, especially for a community bank, is the duty to the community in general. If such a duty is found to exist, the nature of a board of directors' duties, and consequently the analysis required for response to a bid for acquisition, could expand greatly.

(1984). "While the business judgment rule may be applicable to the actions of corporate directors responding to takeover threats, the principles upon which it is founded—care, loyalty, and independence—must first be satisfied." Id.
85. See BLOCK ET AL., supra note 15, at 96.
86. See id.
87. See id; ROBINSON, supra note 13, § 14-5.
88. See DEL. CODE ANN. tit. 8, § 141(e) (1998); N.C. GEN. STAT. 55-8-30(b) (1990).
90. See id.
91. See Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 257 (7th Cir. 1986).
92. See Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985) (stating that consideration of price alone may not be enough).
IV. DUTY TO A BROADER CONSTITUENCY

Any consideration of duties to a broader constituency would have to take place before a company entered the "Revlon moment." If the Revlon rule becomes applicable, all considerations except price become moot. There is, however, some basis in both statutory and case law, for the proposition that directors should take into account a duty to the community when assessing a bid for acquisition under the first prong of Unocal. The existence of a board of director’s duty to a broader constituency is implied in many state statutes. A majority of the states have adopted statutes that allow directors to consider non-stockholder constituencies when assessing bids for acquisition. No state statute, however, explicitly defines a duty to the community. Therefore, the duties owed to the bank’s shareholders (which are explicitly defined) seemingly must take priority. Some case law, including Unocal and Paramount, contain indirect references to a potential duty to a broader constituency, but they by no

93. See supra notes 75-81 and accompanying text. See also Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 182 (Del. 1986); Turner, supra note 15, at 32-33.
94. See Revlon, 506 A.2d at 182.
95. See Hanks, supra note 15, at 1227-30.
96. See A.A. Sommer, Jr., It All Comes Down to Money, Bus. LAW TODAY, Jan./Feb. 1999, at 36, 36. A recent count found 30 states with broader constituency statutes. See id. States with broader constituency provisions in their statutes include: Arizona, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Wisconsin, and Wyoming. See BLOCK ET AL., supra note 15, at 333-34 (1993). Delaware is conspicuously absent from the list, as is North Carolina. See id. Indiana’s statute is typical of most. It states “[a] director may, in considering the best interests of the corporation, consider the effects of any action on shareholders, employees, suppliers, and customers of the corporation, and communities in which offices or other facilities of the corporation are located and any other factors the director considers pertinent.” IND. CODE § 23-1-35-1(d) (1997).
97. Connecticut’s statute is close to establishing an affirmative duty to consider a deal’s impact on a broader constituency. See CONN. GEN. STAT. ANN. § 33-756(d)(4) (West 1997) (stating that a director “shall consider” broader constituencies, including “community and societal considerations including those of any community in which any office or other facility of the corporation is located”). See BLOCK ET AL., supra note 15, at 333.
98. See BLOCK ET AL., supra note 15, at 333. See also Hanks, supra note 15, at 1207.
100. 571 A.2d 1140 (Del. 1989).
means require that community concerns be taken into account. The court in Unocal stated:

A further aspect is the element of balance. If a defensive measure is to come within the ambit of the business judgement rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)...

The Court in Paramount also allowed Time's board of directors wide latitude in weighing considerations other than price. Aside from the implications of Unocal, Paramount, and state statutes, there are three premises upon which a duty to the community might be based. First, the corporate charter, which is akin to a contract between the state, the corporation, and the directors, might create a contractual duty to consider a broader constituency. Second, the Community Reinvestment Act (CRA) requires and evaluates community involvement. Third, a corporation may take on a duty to the community through its long-term behavior as an organization. Over a period of years or decades, community service and involvement could become an element of the bank's corporate culture.

102. See Unocal, 493 A.2d at 955.
103. See supra notes 70-74 and accompanying text. Time was allowed to consider the potential effect the acquisition might have had on its corporate culture. See also Paramount Communications, Inc. v. Time, Inc. 571 A.2d 1140 (Del. 1989).
104. See infra notes 108-17 and accompanying text.
106. See infra notes 118-23 and accompanying text.
107. See infra notes 124-27 and accompanying text.
DUTIES OF DIRECTORS

A. Corporate Charter and Bylaws as a Contract

The corporate charter and bylaws of a bank are basically a contract between the state, the corporation, and the shareholders of the bank. Charters or bylaws are sometimes drafted to contain a provision making a commitment, on the bank's behalf, to community service and involvement. Such provisions in a charter are generally upheld, unless they run contrary to public policy. Provisions of this type are clearly favorable from a public policy standpoint because they are designed to benefit the broader community.

Balancing problems may arise if the director's duty under the charter is at odds with the duty to the shareholders. Delaware courts have held that the duties owed to the shareholders must override any other duties or obligations, including the directors' fiduciary duty to the corporation. However, there has been a recent trend favoring

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109. See CENTRAL CAROLINA BANK, Corporate Bylaws. The bylaws of Central Carolina Bank (CCB) contain such a provision. Article XII of CCB's bylaws reads:

Additional Constituents:
In connection with the exercise of its or their judgement in determining what is in the best interests of the Corporation and its shareholders, the Board of directors of the Corporation, any committee of the Board of Directors, or any individual director may, but shall not be required to, in addition to considering the long-term and short-term interests of the shareholders, consider any of the following factors and any other factors which it or they deem relevant: (i) the social and economic effects of the matter to be considered on the Corporation and its subsidiaries, its and their employees, depositors, customers, and creditors, and the communities in which the Corporation and its subsidiaries operate or are located.

CENTRAL CAROLINA BANK, Corporate Bylaws, Article XII. Such a provision clearly broadens the spectrum of considerations a board of directors may weigh when considering a bid for acquisition. See also Hanks, supra note 15, at 1227-1230.

110. See Frankel v. Donovan, 120 A.2d 311, 316-17 (Del. Ch. 1956).

111. See Hanks, supra note 15, at 1228-29. The author stated that

[the difficulty with these statutes is that they raise and resolve, apparently with very little legislative discussion, one of the most fundamental issues of corporate law: To whom do the directors owe their duties? ... From a simple practical standpoint, as any director of a major corporation knows, it is difficult enough to determine the best interests of the corporation and its stockholders; it would be even more difficult to determine the interests of other constituencies, much less balance the often competing claims of these groups.

Id.

a balancing of contractual rights with Revlon auction duties. A recent Delaware case, The Kontrabecki Group, Inc. v. Triad Park, LLC, enforced a contract which seemingly was at odds with the directors' “Revlon” duties. While this sort of contract is different from the idea that a corporate certificate or bylaws is a contract, the emergence of a trend away from blind allegiance to Revlon’s duty to shareholders seems to be emerging.

In some cases, no conflict may exist between obligations to shareholders and to the provisions of the charter. Shareholders who have made an informed decision to invest in the bank in the first place have, in a way, ratified the charter and are probably unlikely to disagree with its provisions. If the charter provision was disclosed to the shareholder before the investment in the bank was made, the shareholder’s buying of shares could be construed as ratification. Thus, the contractual nature of the corporate charter might go beyond mere support of an obligation to weigh community concerns, to the actual establishment of a duty.

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115. See Varallo & Howard, supra note 113, at 42-46. “At the very least, it now appears as though the court will no longer gloss over such arguments, assuming that, in all cases, the interests of the stockholders must necessarily prevail over the interest of contract parties.” Id. at 46.

116. See Frankel v. Donovan, 120 A.2d 311, 316-17 (Del.Ch. 1956).

117. Uwharrie Capital Corporation’s Bank of Stanly, located in Albemarle, NC, is an example of an institution which seems to have adopted this stance. See UWHARRIE CAPITAL CORP., 1997 Annual Report (1998). The 1997 Annual Report of Uwharrie Capital Corporation includes a list of “Core Values” which states, among other things, that the corporation “will never put profits before the welfare of people;” that activities “will contribute to the literacy and/or economic benefit of our community;” and that success will be measured by “meeting the needs of all of our stakeholders: customers, associates, shareholders, community, region.” Id. at 5.

Similarly, the prospectus for the corporation’s 1998-1999 offering of common stock states, “[t]he Company is community oriented, emphasizing the well-being of the people in its region above financial gain in directing its corporate decisions.” UWHARRIE CAPITAL CORP., Common Stock Offering Prospectus, 2 (1998). These documents are on public record, and thus, it can be argued that shareholders understand and ratify the policies of the bank.
B. The Community Reinvestment Act

In the foregoing respect, bank charters may set standards of director conduct similar to those imposed by the first section of the Community Reinvestment Act.\(^\text{118}\) The first section of the CRA states, "regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business."\(^\text{119}\) The statute lays down a hard and fast requirement, and just as bank directors should ensure that their own institutions meet the requirement, so too should an acquiring firm's ability to meet this requirement be assessed. This would probably take place under the \textit{Unocal} analysis.

This argument is buoyed by the fact that an acquirer's poor CRA rating could stymie future growth by hindering agency approval.\(^\text{120}\) The CRA rating is significant since a poor rating can delay agency approval of future applications for acquisitions or mergers.\(^\text{121}\) Sections 2903 and 2906(b)(2) of the CRA make provisions for a rating system\(^\text{122}\) to evaluate a bank's commitment to the community. The CRA rating could be an important consideration for directors, especially those directors whose banks currently have high ratings and strong community involvement, because the rating could indicate how much a bank's corporate identity as a "community partner" might change as the result of a particular acquisition.\(^\text{123}\)

\begin{footnotesize}
\begin{enumerate}
\item \footnotesize 119. 12 U.S.C. § 2901(a)(1) (emphasis added).
\item \footnotesize 120. \textit{See} 12 U.S.C. §§ 2902(a)(3), 2903(a)(2). CRA ratings are reviewed prior to the granting of approval for future mergers or other agency permits. \textit{See id.} §§ 2902(a)(3), 2903(a)(2). Poor ratings can hinder agency approval. \textit{See id.} §§ 2902(a)(3), 2903(a)(2).
\item \footnotesize 122. The system establishes four classifications: (1) Outstanding, (2) Satisfactory, (3) Needs Improvement, and (4) Substantial Noncompliance. \textit{See} 12 U.S.C. § 2906(b)(2).
\item \footnotesize 123. The CRA was enacted in part to address the practice of redlining. \textit{See} 12 U.S.C. §§ 2901-2907. While redlining is directed at specific neighborhoods, a community bank could have concerns that a potential acquirer might redline the bank's community, a concern reiterated in a recent address given by the Acting Comptroller of the Currency. \textit{See Williams Remarks, supra} note 6.
\end{enumerate}
\end{footnotesize}
C. Implicit Acceptance of a Community Duty

Another way in which the duty to a broader constituency might be supported is through the notion of community reliance. Many small and medium sized community banks have established strong ties with their communities over a period of years or decades. Banks support the local business community through their lending, and some even serve almost as an informal chamber of commerce. They may make donations to support schools and other institutions that enrich the entire community. After a period, a community may very well come to expect that such support will be lent, and the bank’s shareholders and directors may accept that such support is part of the bank’s corporate identity. Long-term community involvement of this nature could result in the community’s reliance on the bank’s continuing commitment.

Long-term commitment to community could also be embraced as part of the bank’s corporate identity. In Paramount Communications, Inc. v. Time, Inc., the court held that incompatible corporate cultures, between acquirer and target, constitutes a valid objection to a proposed merger. Thus, a target bank could argue that an acquirer’s lack of desire to be heavily involved in that particular community would be a threat to its corporate culture. This threat could be very real, as acquirers often look to move into geographic regions precisely because they have historically lacked strong connections with the particular geographic market. This third foundation of the duty to a broader constituency would take time to develop, whereas the first two would not. It would, in all likelihood be applicable only to banks that have become closely associated with a specific area over a long period of time.

124. Returning to the previous example of the Uwharrie Capital Corporation, the Bank of Stanly has involved itself heavily in its community. See UWHARRIE CAPITAL CORP., 11, 1997 Annual Report (1998). The corporation’s annual report lists numerous community programs and organizations it supports, including: county schools, fire departments, law enforcement, Habitat for Humanity, hospitals, and the County Historic Preservation Society. See id. It could be argued that over a period of years, this sort of involvement becomes a part of the corporate identity and something which citizens of the community come to rely on.


126. See id.

127. 571 A.2d 1140, 1153-54 (Del. 1990).
V. CONCLUSION

A board of directors must bear in mind its duty as a fiduciary when responding to an unwanted overture. The duty of care requires that directors make the choice to reject an offer and remain independent only if that decision will benefit the interests of the corporation and shareholders.

Additionally, other considerations may influence the board’s decision. One such consideration is the possible existence of a duty to a broader constituency, such as the community. The Delaware Supreme Court’s decisions in Unocal v. Mesa Petroleum and Paramount Communications, Inc. v. Time, Inc., as well as statutes enacted in several states, give directors latitude to weigh considerations broader than the scope of shareholder interests, including community interests. While these cases and statutes probably do not indicate the existence of an affirmative duty, there are other theories that might support an affirmative duty. The duty to weigh community concerns may be premised on provisions in the corporate charter, on the Community Reinvestment Act, or simply on a bank’s tradition of community involvement and corporate

128. See supra notes 42-88 and accompanying text.
129. See supra notes 89-92 and accompanying text.
130. See supra notes 93-127 and accompanying text.
133. See supra notes 96-98 and accompanying text.
134. See supra notes 104-27 and accompanying text.
135. See supra notes 108-18 and accompanying text.
136. See supra notes 118-23 and accompanying text.
identity. If one or more of these "sources of duty" are found to create an affirmative duty to the community, the result could be a major change in the duties of a board of directors faced with a bid for acquisition.

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137. *See supra* notes 124-27 and accompanying text.

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