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The Impact of Double Trigger Change on Control Agreements

Did it make sense to accelerate all of the severance when not all of the executives are entitled to it under the agreements in place?

Challenge

A community bank was planning a sale to a larger regional bank and our discussion with the community bank's attorney focused on the change in control agreements for the executives.

A great deal of work had been done when the agreements were initially established – and the agreements were designed to protect the community bank's executives in the event of a change in control. At the time, we determined the amount of the severance (enhanced to 18 months or two times base salary, compared to a one times salary for other situations) and carefully considered the triggers that would result in payment of the severance. We concluded that a double trigger agreement was in the best interests of the shareholders.

Both a change in control and a termination of employment would be required for a double trigger. Double triggers would also pass scrutiny of the proxy advisors.

Now, with the sale of the bank being negotiated, the plan was to accelerate and pay all severance for each executive at closing. All executives would receive severance checks, even those who were not losing their jobs.

Why was it necessary to reconsider the severance protection for this executive team? Did it make sense to accelerate all of the severance when not all of the executives are entitled to it under the agreements in place?

Solution

In this case, the severance protection extended to contingent or good reason terminations. All of the executives would lose their current positions and enable the severance even though they may receive offers for new positions with the acquiring bank.

In addition, the acquiring bank was not willing to accept the existing agreements. The regional bank provides similar, but different, protections to their executives and they didn't want to set a precedent of having different agreements in place for their executive team.

As a condition of the transaction, the acquiring bank required all executive agreements of the community bank to be extinguished. New and consistent agreements were developed at the appropriate levels for the executives who would be retained after the acquisition.

"Cashing out" double trigger agreements at closing is very common, especially if there are good reason termination provisions in the agreements. Acquiring banks do not want to deal with severance costs after the transaction and they prefer that the shareholders of the selling bank absorb the costs for the promised severance. Acquiring banks want to selectively identify and extend employment and retention agreements to the executives they wish to retain.

Results

The community bank (a publicly-traded company) set the merger approval process to include a separate filing that asked shareholders to approve (in a "say on pay" advisory vote) the new change in control agreements and severance payments at closing. These amendments are nearly always approved; if the shareholders want the deal, they will approve the amendment.

For the community bank, the shareholders approved the change in control amendment by a narrow margin, while the sale of the bank passed by a landslide. A review of the votes shows the institutional shareholders (represented by the proxy advisors) cast the votes against the amendments. Non-institutional shareholders wanted the sale and approved the change in control agreement amendments.

Double trigger agreements can be quite complicated. The agreements are almost a necessity when established to gain acceptance of proxy advisors, however, double trigger agreements often will reduce to single trigger agreements at the time of a change in control for the various reasons mentioned above, notwithstanding the objection of proxy advisors.

When establishing change of control agreements for executives, single trigger agreements may provide a simpler solution.