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To Our Clients

Enclosed is an updated version of our takeover response outline.

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Discussion Checklist re Takeovers

1. Team to Deal with Takeovers

    a. Company - small group (3-6) of key officers

    b. Law firm - corporate partner and litigation partner; local counsel where needed

    c. Investment banker - current files and periodic due diligence

    d. Proxy soliciting firm (see 20 below re proxy fight)

    e. Public relations firm

    f. Continuing contact and periodic meetings are important

2. No Blackbook

    a. There are no stereotype responses; whatever is necessary can be created in just about the same time as necessary to modify blackbook model

    b. Blackbook type of literary response not effective, but, where liquidation values are high in relation to takeover bid, effort to induce shareholders not to tender may be effective (see 4 below)

    c. Existence of a blackbook can give false sense of security and can be embarrassing in litigation

3. War List of Telephone Numbers of the Team

4. Periodic Team Runthrough of Response to a Hypothetical Takeover Bid

    a. Analysis of loan agreements and indentures with respect to buy back of shares or self tender offers

    b. Authorization of common and preferred stock for acquisition or recapitalization exchange offer

    c. Advance preparation of earnings projections and liquidation values for evaluation of takeover bid and for use in talking to institutional investors

    d. Plan for contacts with institutional investors and analysts

e. Plan for recapitalization exchange offer

f. Plan for liquidation

g. Amendments to stock options, employment agreements, executive incentive plans and severance arrangements

h. Consortium white knights

i. Scorched earth: While the court in the Brunswick case cites the St. Joe case for the proposition that a target cannot have a scorched earth policy merely to thwart a hostile tender offer, the Brunswick court in fact reached the opposite result from St. Joe. The Brunswick case sustains the sale of a major division and the use of the proceeds of the sale for a competing tender offer designed to defeat the hostile tender offer. This is precisely what the St. Joe court, without a reasoned opinion, held to be a prohibited scorched earth defense. Whatever scorched earth may mean, it does not prevent the board of a target company from exercising its business judgment to obtain what it believes to be a better deal for the shareholders. It is believed that the Brunswick case is correct and reflects the law as it is today.

The Brunswick case emphasizes the importance of advance preparation to deal with a hostile tender offer. In Brunswick the sale of the division is pursuant to an agreement by the buyer to tender for Brunswick shares at a price higher than the hostile tender offer and then to exchange those shares for the division. This type of transaction is facilitated if a company in advance identifies a division that would sell for a higher multiple than the company itself, there are separate financials for such a division, and loan agreements are structured so that the sale and stock repurchase can be accomplished without delay or undue penalty.

As the legal defenses to a hostile tender offer have become less and less effective, the structural defenses have become of increasing importance. In many cases a structural response is in fact the very best deal for the shareholders. Structural defenses are difficult and in many cases will be possible only if there has been careful advance preparation by the company and its investment banker and counsel

5. Preparation of CEO

   a. Handling casual passes

   b. Handling offers

6. Preparation of Board of Directors

   a. Periodic presentations by lawyers and investment bankers to familiarize directors with the law and the advisors

   b. Company may have policy of not engaging in takeover discussions

   c. Directors should refer all approaches to the CEO

   d. Distribution of "Takeover Bids in the Target's Boardroom" and related memos

7. Responses to Casual Passes

   a. No duty to discuss or negotiate

   b. No duty to announce

   c. Important to avoid misunderstanding by refusing to meet and firmly and unequivocally rejecting overture in most cases; most raiders go away if rebuffed at the very outset

8. Response to Offers

   a. No response other than will call you back

   b. Call war list and assemble team

   c. No press release or statement other than "stop-look-and-listen" and call of special board meeting to consider

   d. Consider trading halt (NYSE limits halt to short period)

   e. Determine whether to meet with raider

9. Special Meeting of Board to Consider Offer

a. No duty to accept or negotiate a takeover offer

b. Board must act in good faith and on a reasonable basis

c. No director has ever been held liable for rejection of takeover offer. In the Marshall Field case shareholders sued the directors of Field for causing withdrawal of a high premium tender offer by Carter Hawley Hale, following which withdrawal the market price of Field dropped to below its pre-offer level. The actions complained of by the shareholders were: (1) the adoption of a secret policy of remaining independent in the face of any takeover bid, no matter how attractive; (2) the acquisition of stores in substantial competition with stores owned by Carter; and (3) the filing of an antitrust suit against Carter. While recognizing that the desire to fend off Carter and retain control of Field was among the directors' motives in entering into the transactions in question, the court ruled that the shareholders had failed to show that that motive had been the directors' "sole or primary purpose"; under the court's view of the business judgment rule, the fact that one purpose of a transaction may be to consolidate or retain the directors' control does not suffice to shift to the directors the burden of establishing a compelling business purpose for the transaction. The court held that only in the event of "fraud, bad faith, gross overreaching or abuse of discretion" would the business judgment of the directors be questioned; the court thus explicitly refused to apply a "different [business judgment] test in the takeover context"

d. Presentation

(i) Management - budgets, financial position, real values (off-balance sheet values), new products, general outlook, timing

(ii) Investment Banker - opinion as to fairness or adequacy, state of the market and the economy, comparable acquisition premiums, timing

(iii) Lawyer - legality of takeover (antitrust, compliance with SEC disclosure requirements, regulatory approval of change of control, etc.), reasonable basis for board action

e. More than half of the targets of bearhugs remain independent; exchange offers are defeated more than half of the time; about 10% of the smaller targets of any-and-all cash tender offers remain independent; more than half of the any-and-all cash tender offers for major ($ billion plus) companies are defeated

10. <u>Analysis of Raider</u>

a. Investment banker

b. Accountant

c. Lawyer

11. <u>Preparation by Investment Banker</u>

a. Due diligence file and analysis of off-balance sheet values

b. Recapitalization and liquidation alternatives

c. Quarterly review

d. Communication of material developments and regular contact is important

12. <u>Preparation by Lawyer</u>

a. Review of business to determine products and markets for antitrust analysis of a raider

b. Regulatory agency approvals for change of control

c. State takeover laws (less important today)

d. Impact of change of control on business

e. Disclosures that might cause a potential raider to look elsewhere

f. Recapitalization and liquidation alternatives

g. Amendments to stock options, executive compensation and incentive arrangements and severance arrangements

h. Regular communication

13. <u>Shareholder Relations - Usually Not Significant re Takeovers</u>

a. Dividend policy

b. Financial public relations

c. Preparation of fiduciary holders with respect to takeover tactics designed to panic them

d. Contacts with analysts and institutional holders

14. <u>Response to Accumulation in Market</u>

a. Monitoring trading

b. Maintain contact with specialist and arbitrageurs

c. Immediate response to accumulation

(i) Litigation - creeping tender offer

(ii) Purchase of accumulated shares

d. Hart-Scott 10% investment exception

15. <u>Generally Structural Changes such as Staggered Board and Shark Repellent Charter Amendments not Effective</u>

a. Evidence of fear

b. Rejection by shareholders; SEC requires very specific disclosures

c. Not a real deterrent

d. Taints later action by board when an offer is rejected

e. Doubt as to legality

16. Contacts with Potential White Knights and Big Brother Standstill Agreements

    a. Advance contact with potential white knights can lead to misunderstanding and takeover bid in certain cases

    b. Standstill agreement may be detrimental to shareholders (disliked by professional investors who may stir up takeover activity)

    c. Doubt as to legality of standstill agreement if not supported by independent business purpose such as exchange of technology or need for capital

    d. Employee trusts may be effective in certain cases

17. Management Group Schedule 13D

    a. Nature and size of holdings; fiduciary problem

18. Hart-Scott-Rodino Antitrust Act and New Antitrust Policies and Legislation

    a. Hart-Scott prevents Sun-Becton Dickinson approach in big companies but under Hart-Scott still can buy up to $15M even if more than 15% and there is 10% investment exception

19. New Types of State Statutes

    a. Amendments designed to distinguish Kidwell

20. Proxy Fight

    a. Resolution advising sale or liquidation

21. Some Recent Experiences and Important Lessons

    a. Takeovers in the $2-10 billion range are possible. Prior to 1981 it was generally assumed that companies with a market value in excess of $1 billion were relatively safe from a non-negotiated takeover. The Seagram offers for St. Joe and Conoco, the Socal bearhug of Amax and the Mobil bids for Conoco and Marathon show that this assumption is no longer valid

b. While there are white knights for $2-10 billion deals who can act in 10-20 days, it is axiomatic that it is much more difficult to find a white knight for a $2-10 billion deal than for the $100 million to $1 billion deals that were typical during the 1970's. Therefore advance preparation is essential. Potential white knights should be identified and the financial information necessary for white knight negotiations should be kept current. Natural resource companies should keep their reserve reports and appraisals up to date. Close coordination between a company and its investment banker is essential. Whether or not advance contact with a potential white knight is desirable is a question for individual determination and generalization is not appropriate. We continue to believe that advance contact with potential white knights carries significant risk of provoking undesired takeover proposals

c. Cash self-tender offers and preferred stock exchange offers are more likely to be effective in defeating tender offers for large companies than for small companies. With small companies, unless such transactions result in a majority of the stock being in friendly hands, the net effect is to make the overall cost of the takeover lower and thus make it easier rather than more difficult. With large companies this is not a significant factor. Also, it is unlikely that the arbitrage of a $2-10 billion takeover will exceed 10% of the target's shares. Therefore Wall Street does not control the destiny of the large target. If the target has a good story and the institutions can be induced to maintain their investment positions, a restructuring of the capitalization of the target may be an effective defense

d. A raider who springs a tender offer without prior contact with the target is most unlikely to be able to induce the target to enter into discussions with the raider. Where the raider is prepared to negotiate a higher price, one way to achieve negotiations is through an increase in the offer price at the right time. Failure to do so leaves too much room for white knights and foregoes an opportunity to change the psychology of the situation. The shibboleth enjoining bidding against

oneself really has no place in a takeover situation. The best time for such a move is after a litigation victory or just prior to a meeting of the target's board. A raider normally cannot litigate its way to a successful takeover. Accordingly, it is important for the target to be aware of the possible use of this tactic and to prepare its board of directors in advance

e. The NYSE 18-1/2% rule (requiring, on pain of delisting, a shareholder vote to approve issuance of more than 18-1/2% of a company's stock) negates one of the most effective takeover defenses. Frequently a target is able to place 25-35% of its stock in friendly hands at a price in excess of the takeover bid, but is prevented from doing so by the NYSE rule. Where the target's board of directors, on the advice of the target's investment bankers, determines that such a placement is in the best interests of the shareholders, there is no legal reason not to go forward. Delisting is one of the elements to be considered by the board, but should not be overriding in the board's determination. NYSE listed companies would be well advised to seek repeal of the NYSE 18-1/2% rule. The rule was adopted prior to the current wave of takeover activity and operates against the shareholders best interests rather than to protect them as originally intended

f. Despite dicta to the contrary in the St. Joe case, liquidation at a price substantially higher than the takeover bid is a viable alternative and is legal and proper. It is the diametric opposite of entrenchment of management. It can and should be used in appropriate situations

g. Executive incentive plans and severance arrangements should be amended to protect executives in the event of a takeover. If this is not done prior to a takeover bid, there is danger that if it is done in the face of a takeover bid it will not be understood as being appropriate and in the best interests of the company and its shareholders. These amendments have become fairly standard and have been adopted by a large number of companies

h. Marathon-Mobil, Grumman, etc. demonstrate that the antitrust defense is alive and well and can be a show-stopper

i. Mobil-U.S. Steel-Marathon demonstrates that lockups can be counterproductive. While the decision voiding the Marathon lockup options on the ground that they chill the bidding and therefore are a "maniuplation" is an extreme extension of the securities laws definition of "manipulation", it does reflect a growing judicial reaction against these devices. Although lockups may still be appropriate in certain special cases, they are not "boilerplate" to automatically be used in every white knight deal and negotiated acquisition. Indeed, given the litigation potential created by the Marathon decision, as a practical matter lockups may create far more risk than assurance