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To Our Clients

The enclosed article by Michael Schwartz and Sharon Tillman is most timely and significant as we approach the 1984 proxy season. It is must reading.

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RECENT PROXY CONTEST DEVELOPMENTS

By Michael W. Schwartz and Sharon L. Tillman*

In the past several years, proxy contests have become an increasingly prominent part of the corporate scene. Information compiled by the proxy solicitation firm of D.F. King & Co., Inc. indicates an increase in the number of proxy fights -- 25 in 1981 as against 15 in 1979, for example. But more significant is a qualitative change: proxy fights are increasingly occurring at major companies, over major issues of corporate policy.

Moreover, proxy contests are now being waged not only of the traditional kind, aimed at seating an insurgent slate of directors, but also of a new variety -- what we will call the "bust-up proposal" proxy fight -- which seeks to put pressure on the incumbent board to sell or liquidate the company. While both involve competing solicitations for shareholder votes, they may call for different defensive strategies: for example, since a bust-up proposal is typically aimed at putting a company into play (*i.e.*, provoking interest in its acquisition), proxy contest strategy must be

part of a company's over-all planning for dealing with acquisition matters. There is not necessarily a bright line between the two kinds of contests: bust-up proposals may be major planks in the insurgents' platform for an election contest, as in the two attempts by Irwin Jacobs to unseat the Board of Pabst Brewing Company, discussed below.

As the 1984 proxy season approaches, a review of some of the recent experience in this area is in order. The 1982 and 1983 seasons produced a number of important proxy contest rulings by the courts, which cast new light on strategic calls which a lawyer representing one side or the other may be called on to make. Moreover, a variety of novel and ingenious tactics have been employed with which corporate practitioners ought to be familiar.

For it is one of the clear lessons of the past several years that no proxy contest is a "sure thing." The quality of the contestants' strategy and lawyering can have a marked impact on the outcome.

The past several years also suggest that no widely-held public company is immune from a proxy contest. Indeed, as rising stock market values make tender offers less attractive to potential acquirors, the proxy contest "route" may

become all the more attractive. Structural features which may impede or frustrate a tender offer -- e.g., very large size or very high market value -- will not necessarily bar a proxy contest.

More fundamentally, the recent proxy contest "boom" has enlarged the universe of potential adversaries to management, and significantly changed its profile. A proxy contest may be waged by someone who would never be able -- or even want -- to mount a full-scale tender offer. While the insurgent will obviously benefit by having a substantial position in the target's stock, he need not buy control and need not pay above-market prices for the stock he does buy. Indeed, a very significant purpose of the bust-up fight is to show management and the world that, although the dissident holds only a small amount of stock, there is a large amount of "loose" stock available to a bidder.

Companies concerned about the prospect of a proxy contest may wish to consider institution of a "staggered" or "classified" board, under which only a minority of the directors is elected each year.[1] In response to the recent activity, many companies have amended their charters to install a staggered board.[2] During the 1983 shareholders' meeting season, an overwhelming majority of the companies

which proposed staggered boards had them adopted. Contrary to what some observers had predicted, institutional shareholders were generally supportive of these measures.

Yet the staggered board device is no panacea. While it undoubtedly tends to discourage contested elections of directors, it cannot deter bust-up proposals. And a determined bidder is obviously free to seek some or all of the seats which are to be filled in any given year with a view to pressing his policy views from within the board room if successful.

Most importantly, the very attempt to install a staggered board or other defensive provision may provoke a contentious situation or an actual proxy fight. Heightened public awareness of takeover activity has led some shareholders to oppose provisions which are perceived as deterring such activity at their company.[3] Insurgents in an election contest may seize upon defensive provisions as part of their attack on the incumbents, as Alan Clore did in challenging the "golden parachute" plan adopted by Gulf Resources, as discussed below. On the other hand, the 1983 experience summarized above suggests that a properly presented staggered board provision may get a sympathetic reception from sophisticated shareholders, aware of the potential for unproductive disruption inherent in many proxy contests. Thus,

very careful planning must precede the attempt to introduce defensive provisions, as more fully discussed below.

Charter and by-law defenses to one side, incumbent boards of directors ordinarily enter a contest with a substantial edge, and effective defense begins with taking care not to dissipate this advantage. Perhaps most important is the good will and support of institutions and other larger shareholders, whose support can be critical. Their support of management is no longer automatic -- if it ever was -- and, indeed, the perception that they may oppose management has contributed to the increase in proxy contests at major companies with a large institutional following.[4] Careful and responsive treatment of these shareholders is vital; their ability to punish nonresponsive managements is great.

An incumbent board also has many tactical advantages by virtue of its control of the corporate machinery. These range from discretion in the timing and substance of news releases to the issuance of new shares, as in the Global Natural Resources case discussed below. In an extreme case, the GAF/Heyman contest, one incumbent board simply refused to close the polls when it appeared to have lost the election.

Finally, tactical flexibility is critical: no two contests are the same -- not even if conducted between the

same parties, as the Pabst case shows. The situations discussed below clearly demonstrate that each contest must be responded to according to its particular facts.

A. Recent Developments in Contested Elections of Directors.

The classic -- and still most common -- kind of proxy fight is one fought over the composition of a company's board of directors. Several recent situations illustrate interesting tactical approaches and produced some significant judicial decisions.

1. Pabst/Jacobs. -- Irwin Jacobs' two unsuccessful attempts to win control of the Board of Pabst Brewing Company by means of proxy contests illustrate the use of bust-up proposals as part of an election contest. Mr. Jacobs twice campaigned on specific tender offer proposals -- in the second case, running afoul of the SEC's tender offer rules in the process.

Pabst appeared a ripe target for a successful proxy contest when Mr. Jacobs, a Minnesota businessman and investor, announced that he would present a competing slate of director nominees at Pabst's April, 1982 shareholder meeting. Pabst's stock was trading at depressed prices; the incumbents owned less than 2% of the stock, while Mr. Jacobs and his associates

owned some 16% by the time of the meeting; the Board had presided over a very significant decline in Pabst's business, culminating in a substantial loss for the fiscal year immediately preceding the meeting; and Pabst had been led by four different chief executives during that same year. Yet Mr. Jacobs lost in a close contest.

The Board mounted a massive, aggressive solicitation campaign designed to make Mr. Jacobs' personality and business reputation central issues in the contest. The campaign included -- in addition to a conventional proxy statement -- numerous letters and other mailings to shareholders, newspaper advertisements, the opening of a "reverse WATS" 800 telephone number to receive calls from shareholders, and the involvement of senior management in an intensive telephone canvass of larger shareholders.

The Board also made a major effort to cut the ground from under the chief plank in Mr. Jacobs' platform -- his proposal, if elected, to cause Pabst to make an issuer self-tender offer. Mr. Jacobs was plainly appealing to the immediate pecuniary interest of shareholders, trying to capitalize on shareholder discontent over low stock prices. The Board sought to steal Mr. Jacobs' thunder by the very unusual step of "putting the company on the block" -- making public announcements of

its intention to seek out a transaction which would result in cash to the shareholders and even its willingness not to oppose a tender offer proposal for all shares at a particular price. Much later in the long Pabst/Jacobs struggle, Pabst ultimately did strike a partial acquisition deal with another brewing company.

In the proxy contest, the Board was assisted by the actual announcement of several tender offer proposals by third-party bidders during the pendency of the contest. While such proposals might appear to compound an incumbent board's difficulties, Pabst was able to turn them to advantage by using them to demonstrate responsiveness. Conversely, Mr. Jacobs was hamstrung by the damage which endorsement of these proposals might cause to his own takeover ambitions.

Although the effectiveness of solicitation techniques is often very hard to gauge, the effectiveness of Pabst's campaign is suggested by its success in retaining the support of an investment advisory firm whose clients owned in the aggregate more Pabst stock than Mr. Jacobs and his associates. Their inability to appeal to this firm -- whose large holdings made it a swing factor -- undoubtedly cost them the election.[5]

Mr. Jacobs' defeat at the April, 1982 meeting marked not the end but only the beginning of an unprecedented takeover

effort, which ultimately did not succeed. Of relevance here is his September 1982 conduct of a second proxy contest, this time in the form of a solicitation of shareholder "consents" to action without a meeting -- the action being the removal of the recently re-elected Board and its replacement by Mr. Jacobs' slate.

This was an unusual and potentially ingenious step. The use of the "consent" mechanism (as authorized by 8 Del. C. § 228) has rarely been attempted in a public company, so that Mr. Jacobs had the strategic advantage of surprise. Under the solicitation procedures used by Mr. Jacobs, the Board began at a substantial disadvantage because Mr. Jacobs' slate could win as soon as it had gotten sufficient affirmative votes, regardless of where the Board then stood in its solicitation of revocations. (Indeed, as events turned out, the Board never did circulate competing proxy materials.) Moreover, Mr. Jacobs took the position that, if he did not succeed promptly, he could keep the contest running until Pabst's next regular meeting, a period of seven-and-one-half months. Finally Mr. Jacobs had good reason to believe that the composition of the shareholder body had changed significantly since his defeat four months earlier, Wall Street professionals having bought in heavily at the time of his unsuccessful tender offer for Pabst in July, 1982. Thus, even though success would require

the votes of an absolute majority of outstanding shares, as opposed to a majority of a quorum at a meeting, Mr. Jacobs' prospects appeared bright.

By September 20, only 13 days after dissemination of his "consent statement" (i.e., the proxy statement for his solicitation of consents), Mr. Jacobs claimed to have received the votes of 50.7% of the outstanding shares, and demanded that the incumbent Board resign. Once again, however, victory eluded him -- even though he had been soliciting virtually without opposition from the Board which had not yet cleared its consent statement through the SEC.

His failure resulted from the Board's victory in litigation challenging the legality of the consent solicitation procedures devised by Mr. Jacobs. The court decided that, in a number of respects, the procedures were invalid and that Mr. Jacobs' disclosures about them in his consent statement violated the federal proxy rules.

Chief Judge James L. Latchum's opinion decided a number of important questions of first impression about the unusual consent solicitation device.[6] First, he held that, contrary to Mr. Jacobs' position, the maximum time within which corporate action can be taken based on shareholder consents is 60 days from the record date. While this is clearly the

law of Delaware where the record date is established by a board of directors,[7] Mr. Jacobs had claimed that action could be taken at any time until the next annual meeting after a record date established by execution of a shareholder consent. The court rejected this construction of Delaware law and also held that Mr. Jacobs had made a material misstatement, finding that "[a] reasonable shareholder may have given his written consent on the basis of [Jacobs'] statement because he believed that if the consent process were to continue for a 7-1/2 month period, the uncertainties which this procedure would foster would have a detrimental effect upon any potential transaction which the incumbent directors may be contemplating or negotiating."

Second, the court's order also imposed a minimum time requirement on a contested consent solicitation. It directed that in any further solicitation of consents, "any corporate action to be consented to . . . shall not become effective until the thirty-first day from the date the new solicitation materials, cleared by the SEC, are mailed to the shareholders . . . ." The court explained that this provision was meant to assure that shareholders had "sufficient time . . . to receive all material information to make an informed judgment . . . ."

Third, Judge Latchum invalidated the "consent card" which Mr. Jacobs had employed, on the ground that Proxy Rule 14a-4(b)(2), requiring that any proxy form for election of directors provide a means for shareholders to withhold authority to vote for each nominee, applied to a consent solicitation as well as to a conventional proxy solicitation. Mr. Jacobs had argued that the SEC's "clearance" of his consent card, which gave shareholders only an "all or nothing" vote on his slate, must be deferred to by the court in the unusual consent context. But this argument was rejected, the court holding that the rule was "clear on its face" and that "[t]he policies underlying a proxy contest . . . are equally applicable to a contest by consents . . . ."

Finally, in a ruling with application well beyond the proxy fight context, the court decided that Mr. Jacobs had violated Rule 14d-2(b) of the SEC's tender offer rules, which requires one who publicly announces the material terms of a proposed tender offer to actually make the offer within five days of the announcement, or else to withdraw it. The rule's applicability came into question because Mr. Jacobs' consent solicitation materials had stated that his slate intended to cause Pabst to make a cash tender offer for 4,000,000 shares at $23 per share if they were elected. As in the case of Mr. Jacobs' earlier proxy contest, he was obviously premising his

solicitation on an appeal to shareholder interest in a take-over transaction.

Mr. Jacobs sought to counter Pabst's 14d-2(b) argument by relying on the exemption in the tender offer rules for tender offers by an issuer. The court was not persuaded, holding that since Mr. Jacobs was not the "issuer" at the time of the announcement, he was not entitled to the exemption. In response to Jacobs' argument that the proposed offer was a required disclosure under Section 13(d) and the proxy rules, the court noted that Mr. Jacobs could have availed himself, but did not, of a "safe harbor" provision which excuses compliance with the five-day "make or withdraw" rule in the case of an announcement which does not include the number of shares to be sought or the price to be paid. Moreover, by necessary implication, the decision endorsed the position of the SEC Staff that the five-day "make or withdraw" rule would be triggered even by an announcement in a required public filing.[8]

Based on its findings of violations, the District Court invalidated Mr. Jacobs' consents and declared that the Board remained in office. On appeal, the court's order was affirmed in all respects.[9]

2. <u>Gulf Resources/Clore</u>. -- Alan E. Clore's successful proxy contest for control of Gulf Resources & Chemicals

will long be remembered as the fastest proxy war for control ever waged and won by an insurgent. While proxy contests involving large companies usually involve months of preparation, campaigning and litigation, Mr. Clore won control in less than three weeks.

On April 26, 1982, Mr. Clore informed the SEC of his intention to conduct a proxy fight at Gulf Resources' May 11 annual meeting. The next day, he filed simple and straightforward proxy materials, designed to avoid delays at the SEC. It appears that Mr. Clore was able to assemble a team of lawyers, slate of directors, investment bankers and a proxy solicitor within just a week's time.

Mr. Clore's materials were in fact promptly cleared by the SEC and a whirlwind solicitation followed. Mr. Clore made a strong "bust-up" appeal -- though without any specific proposal -- clearly playing to shareholder dissatisfaction over the incumbents' 1980 rejection of a tender offer proposal. He also attacked Gulf Resources' severance agreements with 21 top managers, sharply criticizing these "golden parachutes" in the press and suing to have them voided.

Because much of Gulf Resources' stock was held by brokerage firms, New York Stock Exchange Rules 451 and 452 were of critical importance to both sides. In substance,

they provide that a broker holding stock on behalf of a beneficial owner can only vote according to the owner's instructions, except that if the broker has not received voting instructions and has no knowledge of a proxy contest 10 days before the meeting, he can vote as he pleases. Mr. Clore took out a full page ad to publicize the proxy fight -- preventing brokers from voting without instructions -- and established a communications system whereby nominees of large stockholders could send a "datagram" to brokers indicating their intention to vote for Mr. Clore's insurgent slate. This device proved highly effective. The incumbents, who had mailed their proxy materials to shareholders before Mr. Clore commenced his fight and were obviously expecting a large uninstructed vote, were caught flat-footed and were unable to mobilize votes from beneficial owners.

The swift nature of the contest also impeded management's litigation attack. The company commenced litigation in Texas, Delaware and Utah, but time pressures apparently prevented it from developing evidence to support its claims.

Mr. Clore's novel tactics worked. At the May 11 meeting, he won by a margin of approximately 55% to 45%.

3. Global Natural Resources/Warner. -- In what The New York Times aptly described as "one of the most bizarre

proxy fights in memory" -- over a company formed from the remnants of the old IOS financial empire, virtually all of whose shares were in unregistered, "bearer" form, and involving litigation in Ohio, Florida, New Jersey, Texas and the Chancery Division of England's High Court of Justice -- Global Natural Resources PLC defeated a dissident group led by former U.S. Ambassador to Switzerland Marvin Warner. The case illustrates the power of an incumbent Board to defeat a determined challenge by aggressive corporate action, and the difficulty of blocking such action by even the most extensive litigation.

Global is an unusual company. A United Kingdom corporation, it was formed in 1970 as the successor company to Fund of Funds and IOS Growth Fund ("FOF"), two of the IOS complex of companies. Oil and gas leases and other assets owned by FOF were transferred to Global when IOS fell on hard times; FOF then declared Global's shares as a dividend to FOF holders. However, because anonymity was desired by many IOS investors, an unusual trading instrument called a "warrant to bearer" was issued instead of conventional stock certificates. The holder of such a warrant did not have to register his name and address, thereby assuring continued anonymity.

From a proxy contest point of view, this meant that Global had no stockholder list -- usually a vital factor in a proxy contest -- and that neither side could communicate directly with stockholders. While this might seem to make a proxy fight distinctly unpromising, in fact management could not count on many of the usual advantages of incumbency. Customers of Bear Stearns & Co., a firm which was heavily involved in the contest, owned some 1.8 million shares when the contest was announced; the incumbent directors owned less than 1% of the outstanding shares; "public" stockholders were scattered in countries all over the world; and, most importantly, at past meetings the vast majority of shareholders had never bothered to go through the complex process of voting their "warrants to bearer" (e.g., at the 1981 meeting, only about 28% of the 21,000,000 shares outstanding had voted).

In short, the insurgents -- or "requisitionists," as they are known in English parlance -- seemed to be entering the contest with roughly ten times the number of shares owned by Global's directors, in a situation where solicitation of the ordinary sort would be peculiarly difficult. Moreover their campaign was premised on a bust-up proposal to sell Global's assets and distribute the proceeds to shareholders, which could be expected to be very attractive to shareholders

of a company which had never paid a dividend. Most significantly, after the contest was announced, Bear Stearns succeeded in purchasing for customers the largest single block of Global shares outstanding -- 1.2 million shares held by a Canadian trustee for FOF holders who had never claimed them after the 1970 dividend declaration.

Nonetheless, management won a close victory, defeating all but one of the "requisitionists." Two events were particularly significant in the result, both reflecting the very significant advantages of incumbency. First, with little more than a week to go before the scheduled June 4, 1982 meeting, management announced that the meeting would be delayed until mid-September. One effect of the delay was to enable management to mount a full-scale attack in newspaper ads in various countries against the insurgents -- which probably contributed to the very heavy vote ultimately cast at the delayed meeting. Second, management arranged an acquisition transaction under which it issued 3,250,000 new Global shares, all eligible to vote at the delayed meeting.

The acquisition came under a tenacious litigation attack by the dissidents in no fewer than four different forums. First, suit was filed in the Chancery Division of the High Court of Justice, London, challenging the _bona fides_

of the stock issuance as a matter of corporate law. Extensive affidavits were submitted and a six-day hearing held before the Vice-Chancellor of England. The Vice-Chancellor denied the requisitionists' motion for an injunction against the acquisition.[10] However, he granted an interim stay to permit the Court of Appeals to hear the matter.

While the English action was pending, the requisitionists brought suit in the New Jersey state courts, purporting to premise jurisdiction on the New Jersey residence of Global's president. A two-day hearing was held on the New Jersey court's jurisdiction. The court decided that it lacked jurisdiction of the matter and dismissed the complaint.[11]

Shortly thereafter, the English Court of Appeals affirmed the Vice-Chancellor's denial of an injunction. However, before that decision, still another action had been commenced in federal court in Cincinnati, alleging violations of the federal securities laws. Here the insurgents initially met with some success: they obtained a temporary restraining order against closing the acquisition transaction.[12] The District Court based its decision in part on the controversial decision of the Sixth Circuit in Mobil Corporation v. Marathon Oil Co.[13] It rejected the incumbents' argument that the federal court should defer to the jurisdiction of the English courts.

The District Court's order was appealed to the Court of Appeals for the Sixth Circuit, which treated the restraining order as an appealable injunction and vacated it.[14] The acquisition transaction was promptly closed, with less than a week to go before the delayed meeting.

But the requisitionists were not finished. They commenced suit in a state court in Texas, where the acquired company was located, asking among other things for a restraint against the voting of the newly-issued shares at Global's meeting. Again, the plaintiffs began successfully, obtaining a temporary restraining order from the trial judge.[15] However, the Court of Civil Appeals -- after hearing argument on the Friday evening before the Monday morning meeting in the Isle of Jersey -- dissolved the lower court's restraint.[16]

4. Canal-Randolph/Edelman. -- Canal-Randolph Corporation is a relatively small real estate and stockyard ownership and management company, much of whose stock has historically been owned by investment advisory clients of an English merchant bank; the bank's chairman had for many years been chairman of the Canal-Randolph Board. In mid-1982, investment syndicates organized by a New York investor named Asher Edelman began purchasing Canal-Randolph shares with a view to a possible tender offer or proxy fight for control of the Board at the 1983 shareholders' meeting.

Canal-Randolph's Board would have appeared virtually impregnable to a proxy fight: even though Mr. Edelman's syndicates had accumulated some 20% of the shares by the end of 1982, some 28% of the stock was owned by clients of its chairman's bank -- whose votes would, to say the least, be difficult for Mr. Edelman to attract; an additional 7.7% was owned by customers of another English bank, with close ties to the chairman's bank; and Canal-Randolph's charter did not provide for cumulative voting, and indeed had been amended in 1981, before Mr. Edelman first bought shares, to delete a cumulative voting provision.

Yet Mr. Edelman managed to get cumulative voting reinstalled in the charter, via litigation -- ironically, possibly depriving himself of full control of the Board when, at the eleventh hour, he succeeded in purchasing a substantial number of additional shares, including those of the English bank earlier allied to Canal-Randolph's chairman.

This ironic ending climaxed a proxy contest which, more than most, was won or lost -- or won and lost -- in the courts. Solicitation of the usual sort played no part in the outcome.

Mr. Edelman pursued two principal claims in court: (1) that the full extent of the shareholdings by customers

of the English banks had not been timely disclosed in Schedules 13D -- and that "sterilization" of their votes at the 1983 meeting should be the sanction -- and (2) that the 1981 shareholder vote eliminating cumulative voting should be voided because of alleged non-disclosures and misstatements in the Board's solicitation for that meeting. Mr. Edelman's 13D claims for sterilization got nowhere in court -- Judge Stapleton characterizing his case for sterilization as "insubstantial" -- but he succeeded in having the 1981 vote voided.[17] Judge Stapleton's opinion decided a number of important points.

First was an issue of standing. In order to assert the 1981 claim, Mr. Edelman had recruited as plaintiff a shareholder who, unlike Mr. Edelman, had held stock at the time of that meeting. Company records showed that the plaintiff had not voted at the 1981 meeting. Judge Stapleton rejected the incumbents' argument that he was therefore not a proper plaintiff. Earlier cases had divided on this issue.[18]

The court voided the 1981 vote even though the Canal-Randolph Board, in response to Mr. Edelman's contest, had voluntarily put on the ballot a proposal for the reinstitution of cumulative voting. Judge Stapleton rejected this step as inadequate. He ruled that since reinstitution of

cumulative voting would require an affirmative vote of more than 50% of the outstanding shares, and since the substantial number of shares managed by the chairman's bank could be expected to vote against the proposal, "a proxy favoring cumulative voting appear[s] to be a futile gesture."

The court's opinion is perhaps most significant on the issue of relief. Having found the 1981 proxy materials deficient, and ruling further that the Board's 1983 materials did not sufficiently disclose the deficiencies in the 1981 vote, Judge Stapleton enjoined the scheduled 1983 meeting. The incumbents had argued that the meeting should be permitted to proceed, subject to later review of the vote on the Board's proposal to re-install cumulative voting. But Judge Stapleton rejected this contention, declining to follow numerous other cases which have denied pre-meeting relief.[19] This outcome underscores that despite the "hands-off" attitude frequently shown by courts in proxy contest situations, litigation can be a powerful tool in appropriate cases.

As noted above, the ironic sequel was that it may well have been the shares managed by the chairman's bank which benefited from Mr. Edelman's court-room victory. Subsequent to Judge Stapleton's ruling, Mr. Edelman succeeded in purchasing enough additional shares that he might well have been

able to elect the entire Board but for the reinstalled cumulative voting provision. Because of a settlement of the proxy contest, the election was ultimately conducted for a jointly agreed-to slate and the outcome under cumulative voting was never determined.

5. GAF/Heyman. -- GAF Corporation used high-pressure tactics to forestall -- if not prevent -- what appeared to be certain victory by dissident shareholder Samuel J. Heyman in his proxy contest. The case illustrates the very substantial advantages of incumbency, and the effectiveness of determined litigation by the incumbents.

Mr. Heyman, a Connecticut real estate investor and former federal prosecutor, owned only 5.4% of GAF stock when he announced in mid-February of 1983 that he intended to wage a proxy contest in connection with GAF's April 28, 1983 annual meeting. Yet the threat had to be taken very seriously: GAF's poor stock performance made it an obvious target; and, indeed, Mr. Heyman himself had abandoned a threatened proxy fight the previous year based on GAF Chairman Jesse Werner's agreement to explore a possible merger or sale of the company's roofing business.

When that settlement agreement came unstuck, Mr. Heyman launched a proxy fight. He based his solicitation on

an attack on Mr. Werner's leadership capabilities and on a bust-up proposal -- urging the liquidation of a large portion of GAF's business.

GAF retaliated with a massive litigation campaign and an effort to pre-empt the liquidation issue. GAF filed suit in New York to bar Heyman and his slate from voting their shares or soliciting votes, charging violations of the proxy rules. The litigation came to focus on a Connecticut action commenced by Mr. Heyman's sister alleging a breach of trust by him and his mother. Further, in an attempt to outflank Mr. Heyman, Mr. Werner informed GAF shareholders that a tentative agreement had been reached to sell its roofing business and later announced plans to liquidate the company by selling its "crown jewel" chemical unit.

Despite these efforts, Mr. Heyman's solicitation seemed to be succeeding when a discovery dispute in GAF's New York case led to a surprise victory for the incumbents. A Special Master had barred GAF from discovering any facts relating to the sister's Connecticut action because a confidentiality order entered by the Connecticut judge "intended to prevent any disclosure on the matters he ordered sealed, both in Connecticut and elsewhere"; GAF petitioned the Second Circuit for a writ of mandamus directing the Special Master to

grant GAF discovery on the facts underlying the Connecticut action.

The day before GAF's meeting, the Second Circuit granted GAF's petition and directed discovery.[20] This litigation victory was used by the incumbents to gain crucial additional time. Just before the meeting, the GAF Board met and determined that the stockholders should be informed of the Second Circuit's ruling, as well as any information obtained by GAF's subsequent discovery, before deciding how to vote. The Board therefore decided to take the extremely unusual step of keeping the polls open until final certification of the vote.

At the shareholders' meeting, Mr. Werner announced that the polls would not be closed at the end of the meeting but would be held open until the inspectors had certified the results to permit dissemination of information concerning the Connecticut breach of trust suit. After heated debate, the meeting was abruptly adjourned.

The following day, Mr. Heyman and his dissident slate brought suit in Delaware to force GAF to close the polls as of the date of the annual meeting. According to their complaint, 61.2% of the shares had voted for his slate, while only 38.8% had voted for the incumbents. Mr. Heyman claimed

that the polls had been validly and effectively closed by a shareholder vote at the meeting and that GAF stockholders had validly overruled a ruling by Mr. Werner that a shareholder proposal to close the polls was out of order. However, the Delaware court declined to rule on the matter until the proxies and ballots on all matters voted upon at the meeting had been tabulated.

The action shifted to GAF's New York action. Based upon information obtained in discovery into the facts underlying the Connecticut action, GAF sought and obtained permanent injunctive relief from Judge Lloyd MacMahon, overturning the shareholder vote.[21] The court's opinion is a notable interpretation of the disclosure requirements of the proxy rules.

Judge MacMahon held that Mr. Heyman had knowingly violated Section 14(a) and Rule 14a-9 by failing to disclose in his proxy materials the allegations and underlying facts in the Connecticut breach of trust action. The court stated that the Connecticut lawsuit, which alleged breaches of Mr. Heyman's fiduciary duties in connection with his administration of family trust assets, had a direct bearing on his fitness to serve as a director of GAF and that the "presentation of these facts would have significantly altered the 'total mix' of information available to GAF shareholders." The court

expressly rejected Mr. Heyman's argument that "fitness" disclosure is required only if it pertains to an incumbent director or involves violations of the securities laws or criminal statutes. The court stated: "[T]he concept of materiality is much broader than that suggested by Heyman and . . . it encompasses a past record of violations of fiduciary duties whether or not those violations are related to the securities laws or committed by a sitting director."

The opinion is also significant on the scope of relief. Rejecting Mr. Heyman's request for a narrower order, Judge MacMahon permanently enjoined certification of the vote and concluded that because the insurgents "appear to have prevailed in the election of directors," a full resolicitation was necessary. Mr. Heyman immediately appealed to the Second Circuit; to date, no decision has been rendered.

B. Recent Developments in "Proposal" Proxy Contests

1. "Bust-Up Proposals"

In a number of recent situations, dissident shareholders have instituted proxy contests not to elect their slate of directors but to seek adoption of a proposal aimed at pressuring the Board into seeking the sale or liquidation of the company. These bust-up contests are to be sharply

distinguished from another kind of "proposal" contest -- seeking votes on political or social grounds against company business policies, for example, activities or investments in the Union of South Africa. The latter kind of proposals have rarely attracted any substantial support and, indeed, contests over them have usually been conducted without any solicitation other than brief statements by the proponent and management in management's proxy statement.[22]

In contrast, bust-up proposals, which touch the interests of shareholders *qua* shareholders much more significantly, can garner substantial support and are the subject of full-scale competing solicitations. Even if such a proposal fails to win a plurality, it can be extremely difficult for most Boards of Directors to disregard the substance of the proposal. Indeed the question of whether the proposal receives a plurality is, strictly speaking, irrelevant to the Board's response, since such proposals are technically "precatory," *i.e.*, advisory and non-binding, in any event.[23] The point is that over some period of time, even an "unsuccessful" proxy contest for a bust-up proposal can lead to implementation of the proposal.

While most such contests have happened too recently for this effect to be clearly discernible, it is strikingly

confirmed by the aftermath of one of the earliest proposal contests -- at the 1980 annual meeting of the bank holding company then known as Financial General Bankshares, Inc. That contest was fought over proposals designed to induce management to negotiate with a group of Middle Eastern investors owning 20% of the outstanding stock for the sale of the company to them.

The proxy fight was waged in the context of a long-standing bitter dispute between management and the investors, who were seeking to acquire control by means of a cash tender offer. The battle had included extensive litigation and repeated unsuccessful attempts by the investors to persuade the company to agree to its acquisition.

After nearly two years of hostilities, one of the investors, Kamal Adham, solicited proxies in support of resolutions expressing the wish of the shareholders to consider the investors' proposed tender offer for the company, and recommending that the Board and management facilitate regulatory review. At the April, 1980 meeting, the resolutions failed of adoption, by a vote of approximately 53% to 47%. Yet despite this "defeat," within a matter of months after the meeting the two sides had entered into an agreement for the company's acquisition by the investors. While there remained

many twists in the road before the acquisition was effected -- the first-step tender offer was not commenced until March, 1982, chiefly because of regulatory delays -- the "unsuccessful" proxy contest had clearly been decisive in leading to the ultimate success of the transaction.

The Financial General situation illustrates the use of a precatory proposal to advance, and ultimately to effect, a specific acquisition plan. Because the proponents were themselves willing and able to tender for all the stock of the company, it is somewhat different than more recent contests, where the proponents are not bidders and are seeking either to foment acquisition activity by others or to induce drastic structural changes by the company itself. What the case shows, however, is that proposal proxy contests, unlike election contests, cannot be approached with the view that winning the contest ends the problem. Tactical thinking about the contest must be guided by a broader strategy for the company's defense against takeovers not acceptable to the Board. And success or failure cannot be determined merely by counting the votes.

The 1983 proxy season saw a number of highly publicized proposal contests. At the Trans World Corporation meeting, a group of investors led by the former principals of

Oppenheimer & Co. solicited in favor of a "disaggregation" resolution -- calling for the conversion of the five operating units of Trans World into separate companies, and spinning them off. The insurgents asserted that the market value of the five "disaggregated" companies would be at least twice that of Trans World as a single company. At the Superior Oil Company meeting, an insurgent solicited proxies in favor of a proposal recommending that the Board establish a special committee of three non-management directors which would be required to approve and recommend to the full Board tender offers for 45% or more of Superior's stock at above-market prices, unless the offer were found not to be fair from a financial point of view.

Trans World handily defeated the "disaggregation" proposal, by a nearly 2-to-1 margin, but at Superior Oil the committee proposal was adopted. Both contests were clearly intended to put pressure on the Boards to change fundamental policies, and their ultimate effects are uncertain. However, it should be noted that in late October, the Board of Trans World voted to spin off its Trans World Airlines subsidiary, subject to stockholder approval -- a step which observers attributed in part to the disaggregation proxy contest.

Whatever the final outcome, these contests are clearly straws in the wind. The bust-up proposal proxy fight has become a new fixture on the corporate scene.

2. Proposals by Management.

The strategic thinking required in a proxy contest may also be relevant where a board of directors is proposing what may be controversial charter amendments, notably provisions to forestall unsolicited takeover bids or to provide protections for minority shareholders following a partial, hostile tender offer. Although these situations may not involve formal proxy contests, some of the tactical experience learned in contested situations could well be useful here.

There is no question that these kinds of defensive provisions are increasingly common in response to the proliferation of partial, "front-end-loaded" tender offers: some 90 companies sought adoption of one or another defensive provision at their 1983 shareholders' meetings. While these provoked few formal proxy contests,[24] the introduction of such a proposal by management may encounter resistance not materially different from such a contest.

Accordingly, the most careful analysis and planning is necessary in deciding whether and how to present such

proposals. Of particular importance is the careful explication of the proposal to institutions and other large stockholders. Again, while the 1983 experience indicates that institutions by and large are prepared to support such provisions, such support can in no way be taken for granted. Among the factors to be considered is the overall state of the company's relationships with its institutional holders and the manner in which, in particular, the company has responded to acquisition overtures in the past. Additionally, experience suggests that it is often true that "less is more": attempts to install a wide range of defensive devices may provoke opposition where a more limited defensive effort would win support.

C. Conclusion

Proxy contests have always been colorful and dramatic. They are now increasingly a very high stakes game, and have again become one of the major devices for seeking to effect major change at major companies. The 1982 and 1983 proxy seasons reviewed above are probably only a foretaste of the coming years' battles. As this article is being completed, a major contest is threatened at the Gulf Oil Corporation over its plan to seek elimination of cumulative voting. This and the other developments described above underscore the need for highly sophisticated strategy and tactics in proxy contests.

Footnotes

*The authors are, respectively, a partner and an associate at Wachtell, Lipton, Rosen & Katz, New York, New York. Their firm was counsel to the incumbent Board in the Pabst, Canal-Randolph, Global Natural Resources, Trans World Corporation and Superior Oil proxy contests discussed in this article, and to the insurgents in the Financial General contest.

1. See, e.g., Delaware General Corporation Law § 141(d); New York Business Corporation Law § 704.

2. In order to make a staggered board provision effective, it is necessary to provide that the directors can be removed only for cause. See, e.g., Delaware General Corporation Law § 141(k); New York Business Corporation Law § 706(b).

3. As this article was being completed, a major contest is threatened over the plan of Gulf Oil Corporation to seek repeal of cumulative voting.

4. This perception was certainly a factor in producing the recent bust-up proposal proxy fight at Trans World Corporation, as one of the insurgents has stated, see Levy, "Inside the Battle Over Trans World," Fortune, June 13, 1983, p. 106, and was also a factor in the GAF election contest, see Stewart, "The GAF Proxy Bout," The American Lawyer, July/August, 1983, p. 38.

5. Jacobs wound up suing the advisory firm charging that it had violated the securities laws and that its customers' shares should be sterilized. Charges in his complaint that the firm had been given special promises by the Board to win its votes were dismissed on a Rule 9(b) motion, Jacobs v. Pabst Brewing Co., 549 F. Supp. 1050, 1066-67 (D. Del. 1982), and leave to replead was never sought.

6. Pabst Brewing Co. v. Jacobs, 549 F. Supp. 1068 (D. Del.), aff'd, No. 82-1648 (3d Cir. Dec. 3, 1982). The only other reported case involving a contested solicitation of consents gave rise to the decision in Calumet Industries v. MacClure, 464 F. Supp. 19 (N.D. Ill. 1978) (also involving Delaware law).

7. See Delaware General Corporation Law § 213(a).

8. Exchange Act Release No. 34-16623, reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 24,284I, at 17,757 (Question and Response No. 2).

9. No. 82-1648 (3d Cir. Dec. 3, 1982). Not presented to the Court of Appeals by Jacobs was the District Court's further holding that Jacobs' consent statement had misstated Delaware law in suggesting that revocations of consents solicited by the Board had to be sent to Jacobs, rather than the Board, to be assured of validity. The District Court did not decide the materiality of this misstatement, but its order directed that revocations could properly be sent to the side soliciting them. 549 F. Supp. at 1073-74.

10. Cayne v. Global Natural Resources PLC, 1982 C 5467 (High Court of Justice, Chancery Division (Group A), Aug. 12, 1982).

11. Bear, Stearns & Co. v. Global Natural Resources PLC, Dkt. L-68365-81 (N.J. Super. Aug. 18, 1982), motion for acceleration of appeal denied, N.J. App. Div. Aug. 20, 1982.

12. Warner v. Global Natural Resources PLC, No. C-1-82-820 (S.D. Ohio Aug. 25, 1982).

13. 669 F.2d 366 (6th Cir. 1981).

14. Warner v. Global Natural Resources PLC, Nos. 82-3538, 82-3546 (6th Cir. Sept. 3, 1982).

15. Bear, Stearns & Co. v. Global Natural Resources PLC, No. 82-10240 (Tex. Dist. Ct. Sept. 9, 1982).

16. Global Natural Resources PLC v. Bear, Stearns & Co., No. 05-82-01041-CV (Ct. Civ. App. Sept. 10, 1982).

17. Edelman v. Salomon, 559 F. Supp. 1178 (D. Del. 1983).

18. Id. at 1185. Compare, e.g., Gaines v. Haughton, 645 F.2d 761 (9th Cir. 1981), cert. denied, 454 U.S. 1145 (1982) (shareholder who has not voted cannot challenge allegedly misleading proxy statement in non-derivative action), with Dann v. Studebaker-Packard Corp., 288 F.2d 201, 209 (6th Cir. 1961) ("it is not important whether or not the complaining stockholders were deceived").

19. Recent cases in which pre-meeting relief has been denied, on the basis of no irreparable injury and out of fear that the injunction will unfairly stigmatize the party enjoined, include Unicorp Financial Corp. v. First Union Real Equity and Mortgage Investments, 515 F. Supp. 249, 262-63 (S.D. Ohio 1981), and United Canso Oil & Gas Ltd. v. Clark, 497 F. Supp. 111, 115 (S.D.N.Y. 1980). Judge Stapleton also rejected defendants' claims that the doctrine of unclean hands barred the award of equitable relief, see 559 F. Supp. at 1187-89.

20. Order, In Re GAF Corporation, No. 83-3020 (2d Cir. April 27, 1983).

21. GAF Corp. v. Heyman, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,237 (S.D.N.Y. 1983).

22. The circumstances under which such proposals must be included in management's materials are detailed in the SEC's Rule 14a-8, 17 C.F.R. § 240.14a-8. Rule 14a-8 has recently been amended, see Exchange Act Rel. No. 34-20091, Aug. 16, 1983, [Current] Fed. Sec. L. Rep. (CCH) ¶ 83,417.

23. This is because of the construction uniformly given to state statutes providing, in the language of the Delaware statute, that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ." Delaware General Corporation Law § 141(a).

24. In FMC Corp. v. R.P. Scherer Corp., 545 F. Supp. 318 (D. Del. 1982), litigation was brought by a tender offeror challenging the Board's proposal to amend Scherer's charter to install a "super-majority" provision. FMC also conducted a proxy contest against the provision. The Court denied relief, finding that FMC had not shown irreparable injury.