

December 7, 1988

To Our Clients:

Protect Preferred

We have had several requests for more details about Share Price Protection Preferred Stock ("protect preferred") described in our December 5, 1988 memorandum. Attached is an illustrative term sheet for protect preferred. The design of a protect preferred issue for a company will require a combined financial and legal effort. Like repo rights, and unlike the poison pill, protect preferred is not a basic form with minor variations for each company. Each issue of protect preferred must be specially designed.

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Share Price Protection Preferred Stock

"Protect Preferred"

Illustrative Term Sheet

- General: Protect preferred must be specially designed for each company. This illustrative term sheet gives the basic parameters for that design. Protect preferred is not a "poison pill" and, except to the extent that it creates value and alleviates pressure to restructure, it is not intended to prevent takeovers. The market value enhancement and capital structure created do, however, reduce the likelihood of a takeover bid and make a takeover more difficult. While protect preferred is designed as a preplanning substitute for restructuring through a leveraged recapitalization, it also can be used as a response to a takeover bid.
- Issuance: As a dividend of one share of protect preferred for each common share outstanding. This dividend would be tax-free to the recipient common shareholders. The protect preferred would be Section 306 stock with the principal tax consequence being ordinary income on eventual redemption or sale.
- Regular Dividend: An amount based on the common dividend, equal to approximately 10 to 20% of the common dividend. The common dividend could be reduced to reflect the protect preferred dividend.
- Preference on Liquidation: An amount determined by the regular dividend so that the regular dividend is a market rate yield. For example, if the regular dividend is 50¢ and the company could issue an ordinary preferred at 8%, the liquidation preference would be \$6.25.
- Special Dividend: An amount equal to the difference between whatever target common stock price the company selects and the actual average market price of the common stock for the

60-day period prior to the date (three to six years) set to achieve the target common stock price. If the common stock sells in the market at the target price for a specified period prior to the date set to achieve the target price, no special dividend would be due. The target price would be subject to customary antidilution adjustments.

Dividends
Cumulative:

The regular dividend and the special dividend are cumulative and unpaid dividends accumulate at the company's rate -- in this case 8% per annum.

Exchange for
Common:

Each share of protect preferred is exchangeable at the option of the holder for one share of common at any time upon payment of an amount in cash equal to the target common stock price. The exchange price would be subject to customary antidilution adjustments.

Call Provisions:

Noncallable until a date subsequent to the date set to achieve the target stock price. The longer the noncall period, the greater the value of the exchange-for-common feature. Call price would be equal to the liquidation preference plus accrued unpaid dividends.

Redemption:

Whatever date selected by the company subsequent to the date set to achieve the target stock price -- 5 to 20 years.

Covenants:

No prior preferred. No parity preferred until special dividend has been paid or until after the date no special dividend is payable because target price has been achieved. Limitations on debt, liens and common dividends. Special exception to permit a transaction that results in target price being achieved.

Voting:

Nonvoting except on default in payment of special dividend in which event the protect preferred as a class would have the right to elect one-third of the board of directors. The protect preferred would

also have a class vote on waiver of covenants, with 90% of the outstanding shares necessary to approve a waiver.

Change of Control:

No special provisions necessary. As an option, the target price for either or both the exchange feature and the special dividend feature could be reduced to present value at the date of change of control and the special dividend would become payable on that date.

Exchange for Subordinated Debt:

The company may reserve this option in certain cases.

Accounting:

As long as the common and protect preferred are held as a unit, earnings per unit will not be affected. If for accounting purposes the special cash dividend is required to be amortized, then earning per common share will be reduced and shifted to the protect preferred. This would be calculated on a quarterly basis. Since the protect preferred is a unique concept, the accounting is uncertain. If the amortization approach is adopted, then, until the special cash dividend date, the protect preferred would not be separable from the common and the common and the protect preferred would trade only as units.

Market Value:

Because protect preferred is a new and unique security its value will be uncertain until it is tested in the market. In addition to its value as an ordinary preferred stock, the exchange feature is the equivalent of a deep-out-of-the-money long-term warrant and the special dividend feature is the equivalent of a deep-in-the-money put that only becomes exercisable in the future. The value of these two features will be a function of term, premium to market, volatility, liquidity and the other factors that go into valuation of puts and calls. The value of the call feature is reduced if for accounting purposes trading is lim-

ited to units. It is contemplated that the value of a unit of one common share and one protect preferred share will be significantly greater than the value of one common share prior to the protect preferred dividend.