To Our Clients:

Takeovers Today

There has been a dramatic change in takeovers. The financial corporate raider is gone along with the junk bonds, highly confident letters and bridge loans that made him possible. The fully-financed strategic corporate buyer is back. This has resulted in the need to reexamine and change substantially a company's preparations for defending against a takeover.

The restructuring defense is gone. The demise of the junk bond market and the constricted availability of highly leveraged bank loans forecloses the ability of a target to create restructuring value competitive with a strategic raider's price. A company can no longer depend on a restructuring to defeat a takeover.

The white knight market is limited. Very few companies are willing to compete with a well-priced strategic bid. With the demise of the conglomerate and with most United States companies focusing on core businesses, the number of potential white knights is limited. The flight from leverage and the cultural difficulties many non-U.S. companies have in getting involved in a takeover fight, reduce the white knight potentials even further.

The LBO white knight cannot compete. A well-priced strategic bid and the constricted ability to do a highly leveraged acquisition, foreclose the ability in most cases to provide the equity returns sought by LBO sponsors.

The white squire defense is limited. The NYSE Rule limiting the placement of a white squire block to 20% of the outstanding shares and the difficulty, in the face of a premium tender offer bid, of providing the return a financial white squire expects, limits the availability of this defense.

The poison pill works. The poison pill with a flip-over, flip-in and exchange feature is an absolute defense against open market accumulations, partial tender offers and cash bids for all outstanding shares. In only a very few states is there any question as to the legality of the pill. Many states have enacted statutes that specifically validate the pill. The state of the art pill today has a 10% flip-in threshold, an exchange feature and no provision for defeasance by a shareholder vote or an 85% or

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greater tender. We are in process of updating our clients' pills to the state-of-the-art model.

The pill continues to be attacked by institutional investors through precatory resolutions at annual meetings. These attacks have met virtually no success. Every company should have a state-of-the-art pill.

A company can just say no. The Time-Warner case confirmed that this is Delaware law and about half the states have adopted statutes that permit the board of directors of a target to consider long-term interests and constituents other than shareholders in responding to a takeover bid. It should be part of a company's takeover response planning to document its long-term plans in order to support the defense against a law suit attacking the just say no defense.

Proxy fights are back. The pill and the ability to just say no have revived the proxy fight. The standard approach of the strategic raider is becoming the combination of a tender offer and a proxy fight to replace the target's board with directors who will redeem the pill.

If a company does not have a staggered board and has significant institutional shareholdings, the odds are against being able to get one. Such companies should seek legislation like the new Massachusetts law that mandates staggered boards. Delaware should enact the Massachusetts law.

If a company is subject to the Delaware consent procedure, it should consider a charter amendment to eliminate it. Also, all Delaware companies that are subject to the consent procedure should band together to seek an amendment of the Delaware corporate law eliminating the consent procedure for public companies.

Delaware companies should also seek amendments to the Delaware Business Combination Law to reduce the threshold to 10% and to eliminate the exception if 85% of the shares are tendered.

Bylaw provisions that require prior notice of a proxy fight should be reviewed to be sure they are state of the art and cannot be subverted. Also bylaws that limit the ability to postpone the annual meeting or permit shareholders to call special meetings should be changed.

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Control Share Statutes provide little or no takeover protection and the requirement for a shareholder vote within 60 days threatens other defenses. If possible, companies should opt out. If opt out is not available in a particular state, an amendment to the statute to permit an opt out should be sought.

Employee ownership. ESOPs have become very popular. In many cases -- witness Lockheed -- 20% or more of a company's stock in an ESOP can be a very effective takeover defense.

Interlocking groups. In Japan, West Germany, Canada and most of Western Europe there is interlocking ownership among groups of companies that makes takeovers impossible. Sometimes the interlocks involve joint ventures and sometimes just cross-ownership of stock. The beginnings of this structure are emerging from the white squire activities of funds like Corporate Partners and investors like Warren Buffett and the public offerings by companies that are part of Kohlberg Kravis Roberts and other LBO sponsor groups.

Joint ventures. The high cost of research and development is spurring joint ventures, particularly among Japanese, German and U.S. companies. Frequently takeover protection is built into these arrangements.

Common stock mergers. The changes in the type of takeover activity and in the legal climate have revived common stock mergers like Squibb and Bristol Meyers and Beecham and Smith Kline. The window for this type of combination remains open.

Foreign raiders. The advantage of a cheap dollar and higher price earnings multiples in their home markets have given foreign strategic buyers a major advantage in acquiring U.S. companies. Exon-Florio and the negative reaction to hostile bids by non-U.S. companies make defense against a hostile bid by a foreign company more likely of success than heretofore, but in no way fully counterbalance the foreign takeover advantage.

Federal legislation. While there are several bills in Congress, it appears doubtful that anything meaningful will emerge. The Treasury has a task force examining corporate governance with a view toward changes that will encourage long-term planning. So far nothing has emerged from Treasury.

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The corporate governance debate. The debacle caused by the junk-bond, bust-up takeover era has opened the opportunity to reexamine our concepts of corporate governance. We should have a system for the 21st century not the system inherited from the 19th century we now have. I have suggested a debate of my proposal to eliminate hostile takeovers and to substitute quinquennial election of directors in a manner that requires that they run on their five-year record and their strategic plans for the next five years.

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In light of these dramatic changes, companies should review their preparations for response to a takeover bid.

M. Lipton

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