Revised: March 1, 1995
M. Lipton

Takeover Response Checklist

Merger activity in 1994 was at almost the same level as the historic high of 1988. There were $329 billion of mergers in 1994 as compared to $341 billion in 1988.

Hostile takeovers, which all but disappeared in 1991 and 1992, came back strongly in 1994. Major companies were involved in many of the hostile bids, such as:

American Home/American Cyanamid
Union Pacific/Santa Fe Pacific
General Electric/Kemper
American General/Unitrin
Northrup/Grumman
Rockwell/Reliance Electric
California Energy/Magma Power

Traditional arbitrageurs do not today have the capital they had in the 1980s, but in recent months they have been supplemented by hedge funds so that the aggregate capital available for arbitrage is even greater today than it was in the 1980s.

While much of the acquisition activity has been concentrated in four areas -- (1) defense contractors, (2) healthcare, (3) financial services and (4) communications/media -- there are signs that it may spread to energy and retailing and other industries.

Adding to the acquisition activity has been the significant pressure from activist institutional shareholders on multi-industry companies to spin-of or sell underperforming divisions or divisions that sell at low price earnings multiples and are perceived (rightly or wrongly) as dragging down the market valuation of the remaining high-multiple business.

The Grumman, Santa Fe Pacific and Reliance Electric situations show that strategic mergers -- even multibillion dollar deals -- can generate the same type of competitive activity as the financially motivated takeovers of the 1980s. The same reasons that lead a company for a strategic acquisition explain the increase in initial hostile takeover attempts.

Further fueling the new takeover activity are the renewed availability of bank financing, the revival of common stock pooling mergers (particularly in financial services and

healthcare), the markets' acceptance of junk bonds and derivatives as takeover currency, the markets' disregard of goodwill in acquisitions by "cash flow" companies such as those in communications/media, the belief that activist institution investors will force the boards of targets to "maximize shareholder value" and the erroneous, but widely held, view in boardrooms that the poison-pill-just-say-no defense is no longer feasible.

The present takeover environment warrants reexamination of strategic plans, takeover response preparation and senior managements' and directors' understanding of current legal and tactical thinking with respect to takeovers. Many companies have neglected takeover response preparation during the period of reduced activity since 1989. Today it is prudent to revisit the subject.

This outline provides a checklist of matters to be considered in putting a company in the best possible position to respond to a takeover bid or a proxy fight. Not all the matters in this outline are appropriate for any one company. Takeover defense is an art, not a science. It is essential to be able to adopt new defenses quickly and be flexible in responding to changing takeover tactics. Whatever the state of the law may be and however it may change, in order to achieve the best result in a takeover situation a company must have effective defenses and keep them up to date.

1. Team to Deal with Takeovers

   a. Small group (2-5) of key officers plus lawyer, investment banker, proxy soliciting firm, and public relations firm

   b. Continuing contact and periodic meetings are important

   c. A fire drill every six months is the best way to maintain a state of preparedness

2. War List of Telephone Numbers of the Team and Ability to Convene Special Meeting of Board in 24 to 48 Hours

   a. Instructions for dealing with

      (i) press

      (ii) stock exchange

      (iii) directors

      (iv) employees

3. Structural Defenses

a. In many cases a structural defense will be possible only if there has been careful advance preparation by the company and its investment banker and counsel

b. Poison pill

c. Restructuring; self tender; spin-off; targeted stock

d. Structure of loan agreements and indentures

e. Authorization of sufficient common and blank-check--preferred stock

f. Advance preparation of earnings projections and liquidation values for evaluation of takeover bid and alternative transactions

g. Plan for contacts with institutional investors and analysts and with media, regulatory agencies and political bodies

h. Amendments to stock options, employment agreements, executive incentive plans and severance arrangements (golden parachutes and tin parachutes) -- protection of overfunded pension plans

i. White squire arrangements

j. ESOP arrangements; plans to increase employee ownership

k. Charter and by-law amendments with respect to change of control

l. Amendments to employee stock plans with respect to voting and accepting a tender offer

m. Options under state takeover laws

4. Preparation of Board of Directors to Deal with Takeovers

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

b. Company may have policy of continuing as an independent entity

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

d. Directors must guard against subversion by raider and should refer all approaches to the CEO

e. Avoiding being put in play; psychological and perception factors may be more important than legal and financial factors in avoiding being singled out as a takeover target

5. Preparation of CEO to Deal with Takeover Approaches

a. Handling casual passes

b. Handling offers

c. Communications with officers and board of directors

6. Responses to Casual Passes

a. No duty to discuss or negotiate

b. Response to any particular approach must be specially structured; team should confer to decide proper response

c. Keeping the board advised

7. 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 (refusal to meet may be a negative factor in litigation)

f. Schedule 14D-9 must be filed within 10 business days and must disclose "negotiations"

8. Special Meeting of Board to Consider Offer

a. A premium over market is not necessarily a fair price; a fair price is not necessarily an adequate price

b. No duty to accept or negotiate a takeover offer; where outside directors are a majority, there is no

need for a special committee to deal with takeovers

c. Board must act in good faith and on a reasonable basis; business judgment rule applies to takeovers (modified rule applies in Delaware)

d. Board may consider

(i) inadequacy of the bid

(ii) nature and timing of the offer

(iii) questions of illegality

(iv) impact on constituents other than shareholders

(v) risk of nonconsummation

(vi) basic shareholder interests at stake, including the past actions of the bidder (greenmail, etc.)

e. 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.), bidder's history, reasonable basis for board action

f. Front-end-loaded, two-tier offers and partial offers present fairness issues which in and of themselves may warrant rejection and strong defensive action

g. The "Just Say No" response was approved in the Time Warner case and the Paramount case reaffirmed that holding

9. Preparation by Investment Banker

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

b. Recapitalization, spin-off and liquidation alternatives

c. Semi-annual review

d. Communication of material developments and regular contact is important

10. Preparation by Lawyer

a. Structural defenses such as poison pill

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

c. Regulatory agency approvals for change of control

d. Impact of change of control on business

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

f. Recapitalization, spin-off and liquidation alternatives

g. Amendments to stock options, executive compensation and incentive arrangements and severance arrangements -- protection of pension plans

h. ESOPs and other programs to increase employee ownership

i. Regular communication and periodic board presentations are important

11. Shareholder Relations

a. Restructuring

b. Dividend policy

c. Financial public relations

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

e. Contacts with analysts and institutional holders

f. Activist institutional investors and corporate governance and proxy issues

12. Response to Accumulation in Market

a. Monitoring trading

b. Maintain contact with specialist

c. Schedule 13D -- 5%, Hart-Scott -- $15M/10%

d. Duty of board to prevent transfer of control without premium

e. Disruption of executives, personnel, customers, suppliers, etc.

f. Uncertainty in the market; change in shareholder profile

g. Immediate response to accumulation

(i) Poison pill can be structured so that flip-in takes effect at 10% to 15% threshold

(ii) Litigation

(iii) Standstill agreement

13. Staggered Board and Shark Repellent Charter Amendments Have Not Proved Effective Against Any-and-All Cash Tender Offers but May Be Effective as to Partial and Front-End--Loaded Offers, Proxy Fights, or other Bust-Ups

a. While staggered election of the board of directors and super-majority merger votes or other shark repellents have proved not to be effective in deterring any-and-all cash tender offers, they may be effective in deterring the other types of takeovers (including proxy fights) and are worth having, if obtainable (negative reaction of institutional investors).

14. Contacts with Potential White Knights and Big Brother Standstill Agreements (White Squire Arrangements)

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

d. Swap of voting stock and mutual standstill agreements

e. Employee trusts may be effective in certain cases

f. White squire funds

15. Hart-Scott-Rodino Antitrust Act and new Antitrust Policies and Legislation

    a. Hart-Scott should prevent dawn raids on big companies but under Hart-Scott a raider still can buy up to $15M even if more than 15% and there is a 10% investment exception that has been misused by raiders

    b. While Clinton Administration has more aggressive antitrust enforcement views than Reagan-Bush Administrations as to vertical mergers and as to horizontal mergers affecting innovation markets or causing unilateral effects proscribed under the merger guidelines, the current approaches in the Administration and Congress generally do not deter big conglomerate acquisitions

16. The Role of the Arbitrageur, Hedge Fund and Institutional Investor

17. State and Federal Legislation

    a. Pill validation

    b. Constituencies

    c. Long-term vs. short-term

    d. Disclosure