Revised: May 1, 1997
M. Lipton

Takeover Response Checklist

Merger activity in 1997 is continuing the record setting pace of 1996. In 1996 we had the highest dollar volume of mergers in history, over $1 trillion on a worldwide basis.

Hostile takeovers, which all but disappeared in 1991 and 1992, reappeared in 1995 and have continued. The financial raiders of the 1980s have faded from the scene to be replaced by major companies. Major companies, such as IBM, Hilton, Ingersoll-Rand, Johnson & Johnson, Norfolk Southern, Wells Fargo and Western Resources, have made hostile bids in the past few years.

Traditional arbitraguers do not today have the capital they had in the 198Os, but in the last few years 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 -- it is now spreading to high-tech, energy, retailing, utility, transportation and other industries.

Adding to the acquisition activity has been the significant pressure from activist institutional shareholders on multi-industry companies to spin-off 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. Major companies such as AT&T, Baxter, Dun & Bradstreet, IT&T and Monsanto, and numerous others, have undertaken complex spin-offs. Chrysler and RJR Nabisco have been the targets of proxy fights by corporate raiders who have sought to enlist the support of traditional institutional investors.

Situations such as Norfolk Southern's decision to make a hostile bid for Conrail after Conrail entered into a merger agreement with CSX, Western Resources' bid for Kansas City Power and Light after KCP&L entered into a transaction with UtiliCorp United, the decision by Softkey to break-up the Learning Company/Broderbund transaction and Benckiser's attempt to break-up the L'Oreal/Maybelline transaction, show that the strategic transactions of the 1990s can generate the same type of competitive activity as the financially motivated takeovers of the 1980s. The same reasons that lead a company to compete 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 healthcare and high-tech), 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 institutional 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.

Today's hostile takeovers are often accompanied by a consent solicitation or proxy fight in order to increase the pressure on the target company's board of directors. However, as seen in several recent transactions, the fact that a hostile bidder prevailed in a proxy contest did not always result in the hostile bidder acquiring the target company, as staggered boards prevented hostile bidders from obtaining full control of the target's board.

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.

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, a proxy fight or a consent solicitation. 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 to 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.

Advance Preparation

1. Assemble 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. Create war list of telephone numbers of the team

   c. Ensure ability to convene special meeting of board within 24 to 48 hours

   d. Continuing contact and periodic meetings are important

   e. A periodic fire drill is the best way to maintain a state of preparedness

2. Prepare Instructions for Dealing with:

   a. Press

   b. Stock Exchange

   c. Directors

   d. Employees

   e. Customers/suppliers

   f. Institutional investors

3. Review Structural Defenses, Consider Implementing Additional Defenses If Necessary

a. Bear in mind:

- 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 (see 7. and 8. below)
- While staggered election of the board of directors and supermajority merger votes or other shark repellents have proved not to be effective in defeating 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 (but consider negative reaction of institutional investors).

b. Charter and bylaw provisions

- Staggered board
- Ability of stockholders to act by written consent
- Advance notice provisions
- Ability of stockholders to call a special meeting
- Ability of stockholders to remove directors without cause
- Ability of stockholders to expand size of board and fill vacancies
- Supermajority voting provisions (fair price, etc.)
- Authorization of sufficient common and blank-check preferred stock
- Cumulative voting
- Preemptive rights

c. "Poison pill"

- "Dead Hand" provision
- Purported antidotes ineffective
- Fleming case

d. Structure of loan agreements and indentures

e. ESOP arrangements; plans to increase employee ownership

f. Options under state takeover laws

- Control share
- Business combination
- Fair price
- Pill validation
- Constituencies
- Long-term vs. short-term
- Disclosure

4. Consider Additional Advance Prenaration

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

b. Amendments to stock options, employment agreements, executive incentive plans and severance arrangements ("golden parachutes")

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

d. Protection of overfunded pension plans

e. White knight/white squire arrangements

- Advance contact with potential white knights can lead to misunderstanding and takeover bid in certain cases
- Standstill agreement may be detrimental to shareholders (disliked by professional investors who may stir up takeover activity)
- Issue as to legality of standstill agreement if not supported by independent business purpose such as exchange of technology or need for capital
- Employee trusts may be effective in certain cases
- Consider swap of voting stock and mutual standstill agreements
- Consider white squire funds

f. Restructuring -- sale of division, spinoff, tracking stock (Morris Trust spinoff-merger to be eliminated as of April 16, 1997)

5. Shareholder Relations

   a. Review dividend policy and other financial public relations

   b. Prepare fiduciary holders with respect to takeover tactics designed to panic them

   c. Plan for contacts with institutional investors (including maintenance of an up-to-date list of holdings and contacts) and analysts and with media, regulatory agencies and political bodies

   d. Remain informed about activist institutional investors and about corporate governance and proxy issues

   e. Consider the role of arbitraguers and hedge funds

6. Prenare Board of Directors to Deal with Takeovers

   a. Schedule periodic presentations by lawyers and investment bankers to familiarize directors with the takeover scene and the law and with their 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. Avoid 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

   f. Review corporate governance guidelines and reconstitution of key committees

7. Prenaration bv Investment Banker

   a. Maintain up to date due diligence file and analysis of off-balance sheet values

   b. Consider recapitalization, spin-off and liquidation alternatives

   c. Perform semi-annual review

   d. Communication of material developments and regular contact is important

8. Prenaration by Lawyer

a. Review structural defenses such as poison pill

b. Review charter and bylaws, ensure they reflect "state of the art"

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

d. Understand regulatory agency approvals for change of control

e. Consider impact of change of control on business

f. Consider disclosures that might cause a potential raider to look elsewhere

g. Consider recapitalization, spin-off and liquidation alternatives

h. Consider amendments to stock options, executive compensation and incentive arrangements and severance arrangements, and protection of pension plans

i. Consider ESOPs and other programs to increase employee ownership

j. Regular communication and periodic board presentations are important

9. Prepare CEO to Deal with Takeover Approaches

a. Handling casual passes

b. Handling offers

c. Communications with officers and board of directors

d. Company may have policy of not commenting upon takeover discussions and rumors

Responding to Bidder Activity

1. Types of Activity

a. Accumulation in the market

b. Casual pass/non-public bear hug

c. Public offer/public bear hug

d. Tender offer

e. Proxy contest

2. Responses to Accumulation in the Market

a. Monitor trading

b. Maintain contact with specialist

c. Look for bidder Schedule 13D and Hart-Scott-Rodino filings:

-- 13D: within 10 days of crossing 5% threshold
-- HSR: prior to crossing $15 million or 10% threshold

d. Board has duty to prevent transfer of control without premium

e. Monitor/combat disruption of executives, personnel, customers, suppliers, etc.

f. Monitor uncertainty in the market; change in shareholder profile

g. Consider immediate responses to accumulation:

- Poison pill can be structured so that flip-in takes effect at 10% to 15 % threshold (N .Y. corporations 20%)
- Litigation
- Standstill agreement

3. Effect of Hart-Scott-Rodino Antitrust Act and Antitrust Enforcement Policies

a. Hart-Scott should prevent dawn raids on big companies but under Hart-Scott a raider in some cases 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. A raider cannot complete its purchases until the requisite waiting period has expired:

- Cash tender offer: 15 calendar days
- All other situations: 30 calendar days

c. While the Clinton Administration has more aggressive antitrust enforcement views than the 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 Clinton Administration and Congress generally do not deter big conglomerate acquisitions

4. Responses to Casual Passes/Non-Public Bear Hugs

   a. No duty to discuss or negotiate

   b. No duty to disclose unless leak comes from within

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

   d. Keep the board advised

5. Response to Public Offers/Public Bear Hugs

   a. No response other than "will call you back"

   b. Call war list and assemble team; inform directors

   c. Call special board meeting to consider bidder proposal

   d. No press release or statement other than "stop-look-and-listen"

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

   f. Determine whether to meet with raider (refusal to meet may be a negative factor in litigation)

   g. In a tender offer, Schedule 14D-9 must be filed within 10 business days and must disclose:

      - Board's position (favor; oppose; neutral) and reasoning
      - Negotiations
      - Banker's opinion (optional)

6. Special Meeting of Board to Consider Offer

   a. Board should be informed of the following:

      - Board has no duty to accept or negotiate a takeover offer
      - A premium over market is not necessarily a fair price; a fair price is not necessarily an adequate price
      - The "just say no" response was approved in the Time Warner case and reaffirmed in the Paramount and Unitrin cases
      - Where outside directors are a majority, there is no need for a special committee to deal with takeovers

- Board must act in good faith and on a reasonable basis; business judgment rule applies to takeovers (modified rule applies in Delaware, where defensive action must be proportional to threat)

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

b. Presentation:

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

- Investment banker -- opinion as to fairness or adequacy, assessment of bidder, quality of bidder's financing, state of the market and the economy, comparable acquisition premiums, timing

- Lawyer -- terms and conditions of proposal, legality of takeover (antitrust, compliance with SEC disclosure requirements, regulatory approval of change of control, etc .), bidder's history, reasonable basis for board action

c. Board may consider:

- inadequacy of the bid

- nature and timing of the offer

- questions of illegality

- impact on constituents other than shareholders

- risk of nonconsummation

- qualities of the securities being offered (if bid is not all cash)

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

Strategic Alternatives

1. Remaining Indenendent

a. "Just say **no"** defense is available as a legal matter, but may not be available in practice

- Refuse to redeem poison pill

- Wage proxy fight to keep control of board (if board is staggered, bidder cannot get control and redeem pill without two annual meetings)

b. Consider white squire arrangements

c. Consider actions which decrease the Company's attractiveness as a takeover target

- New acquisitions (e.g., to create antitrust problems for bidder or increase size of transaction for bidder)
- Asset sales or spin-off
- Share repurchases/self-tender
- Issue targeted stock
- Recapitalization
- Note that most of these actions will prevent pooling of interests treatment for future transactions, possibly making it more difficult to enter into a friendly transaction

2. Sale of the Company

a. Options:

- Locate white knight
- LBO/MBO
- Auction
- Sell significant subsidiary or division ("crown jewel" or other)
- Negotiate with bidder

b. Bear in mind: if Revlon duties are triggered, board will not be able to reverse course